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Practical Financial Management : a handbook for the Defense Department Financial Manager / 9th ed. / 2010

Potvin, Lisa

Monterey, California ; Naval Postgraduate School

PRACTICAL FINANCIAL MANAGEMENT

A Handbook for the
Defense Department Financial Manager

NAVAL POSTGRADUATE SCHOOL

Graduate School of
Business & Public Policy

Monterey, California


One Hundred Eleventh Congress
of the
United States of America

AT THE FIRST SESSION

Begun and held at the City of Washington on Thursday, the sixth day of January, two thousand and nine

An Act

Making appropriations for the Department of Defense for the fiscal year ending September 30, 2010, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

That the following sums are appropriated, out of any money in the Treasury not otherwise appropriated, for the fiscal year ending September 30, 2010, for military functions administered by the Department of Defense and for other purposes, namely:

TITLE I

MILITARY PERSONNEL

MILITARY PERSONNEL, ARMY

For pay, allowances, individual clothing, subsistence, interest on deposits, gratuities, permanent change of station travel (including all expenses thereof for organizational movements), and expenses of temporary duty travel between permanent duty stations, for members of the Army on active duty, (except members of reserve components provided for elsewhere), cadets, and aviation cadets; for members of the Reserve Officers' Training Corps; and for payments pursuant to section 156 of Public Law 9[illegible] 377, as amended (42 U.S.C. 402 note), and to the Department of Defense Military Retirement Fund, $41,003,612,000.

MILITARY PERSONNEL, NAVY

[illegible] allowances, individual clothing, subsistence, interest on deposits, grat[illegible] [illegible] of station travel (including all expenses thereof for organiz[illegible] [illegible] of temporary duty travel between permanent duty [illegible]

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Practical Financial Management:

A Handbook for the Defense Department Financial Manager

Editor: Lisa Potvin, CDFM-A

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United States Naval Postgraduate School, Monterey, California

Comments, corrections, and suggestions can be sent to pcc@nps.edu.

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Table of Contents

Table of Figures

Introduction to the text

The 9th edition to ***Practical Financial Management: A Handbook for the Defense Department Financial Manager*** continues in the tradition of its predecessors. Recognizing the strategic importance of the Navy's financial managers, this text attempts to support the mid-level financial manager with aspirations for increasingly significant leadership positions.

The first portion of the text provides the historical and political context for defense financial management. Chapter 1 starts with the Constitutional basis and takes a cursory look at the financial history of the republic paying attention to the historical context and motivation for the significant budgeting and financial management legislation. Attention then turns in Chapter 2 to the source of funds for DoD: Congress. Included are the Congressional budget process, important budget legislation, and the flow of funds from the appropriation to the end user. This is followed by Chapter 3 which looks at the defense budget in relation to the entire federal budget.

The second part of the text, Chapters 4 through 6, looks at the bottom-up process for resource allocation: an overview of the PPBE process and participants, as well as budget formulation and review. The intent is to give the financial manager an appreciation for how resource allocation decisions are made within DoD so that they can influence the process to advance the needs of their organization, program, or activity.

Having covered the process for obtaining funds, Chapters 7 through 9 examine the characteristics of the funds available to an organization, program or activity: appropriated, reimbursable and revolving funds. The intent of these chapters is to give the financial manager an appreciation for how funds move within DoD and for how funds may and may not be used. The desired outcome is for financial managers to better manage the mix of funding to achieve department goals.

The remaining chapters address stewardship and accountability. Chapter 10 covers DoD accounting terminology, classifications, the role of the Defense Finance and Accounting Service (DFAS) and highlights the distinction between financial, managerial and budgetary accounting. Chapters 11 covers cost elements and management issues important to a financial manager in budget execution. Although contract management is a separate area of expertise, financial managers must have awareness of how this system works. Chapter 12 provides a general overview of contracting to assist financial managers in understanding their role relative to the contracting process. Finally, Chapter 13 addresses Internal Controls (including auditing and property accounting.) The intent of this part of the text is to ensure the financial manager appreciates the accountability aspects of their responsibilities and has the tools to ensure accountability is maintained while programs are effectively executed.

Acknowledgements

This text is a synthesis of the work completed over many years. Several members of the Financial Management (Budgeting & Public Policy) faculty of the Naval Postgraduate School, both past and present, as well as their students, have contributed to this book. The current faculty is:

Lecturer, Lisa F. Potvin

Professor Lawrence R. Jones, Wagner Chair

Associate Professor Dick Doyle

Senior Lecturer, Philip J. Candreva

Senior Lecturer, John E. Mutty

Senior Lecturer, Rene Rendon (Acquisition)

Lecturer, Donald C. Summers

Chapter 1: The Financial Management Functions of Government

Overview

This chapter introduces the financial management functions of government, the shifts in power orientation between the branches of government, and discusses the flow of funds through our system of government.

The Constitutional and Legal Basis

Nearly all of the financial management powers articulated in the Constitution of the United States rest with the legislative branch (Congress). However, the responsibility for properly managing those funds once enacted rests with the Executive Branch (The President). Article 1 of the Constitution outlines the powers of the legislative branch. Sections relevant to financial management include:

> ***Section 2:*** *Representatives and direct taxes shall be apportioned among the several states which may be included within this union,*
> ***Section. 7:*** *All bills for raising revenue shall originate in the House of Representatives;*
> ***Section. 8:*** *The Congress shall have power to lay and collect taxes, duties, imposts and excises, to pay the debts and provide for the common defense and general welfare of the United States; but all duties, imposts and excises shall be uniform throughout the United States;*
> *To borrow Money on the credit of the United States;*
> *To coin money, regulate the value thereof, and of foreign coin, and fix the standard of weights and measures;*
> *To provide for the punishment of counterfeiting the securities and current coin of the United States;*
> *To raise and support armies, but no appropriation of money to that use shall be for a longer term than two Years;*
> *To provide and maintain a navy;*
> ***Section 9:*** *No capitation, or other direct, tax shall be laid, unless in proportion to the census or enumeration herein before directed to be taken. (amended by Article XVI, below)*
> *No tax or duty shall be laid on articles exported from any state.*
> *No money shall be drawn from the treasury, but in consequence of appropriations made by law; and a regular statement and account of the receipts and expenditures of all public money shall be published from time to time.*

Further, the Sixteenth Amendment (ratified in 1913) states:
The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several states, and without regard to any census or enumeration.

The Constitution articulated the following financial management functions of government:

- Raising revenues through taxation, duties, imposts, and excises.
- Payment of debts
- Borrowing money on the credit of the United States
- Coining and printing money
- Appropriating monies for particular uses
- Accounting for receipts and expenditures of public funds

In addition to the Constitution, there is a significant body of federal law that defines financial management functions of government. These functions have been created in order to facilitate the orderly functioning of the Constitutional powers, to ensure economic use of funds and to increase the likelihood programs achieve their intended purpose. Such functions include:

- Program analysis and evaluation
- Investment, or capital, planning
- Budgeting – both operational and capital
- Property and inventory accounting
- Auditing
- Stewardship of various trusts and accounts

While some of these functions are analogous to the corporate model with treasury, audit, controller, and budget functions, there are certainly some significant differences.

This text will concentrate on those functions most relevant to a financial manager[1] within the Department of Defense. That subset of financial management functions includes all of the above except the raising of revenues, borrowing or coining money, and management of trusts.

A Brief Financial History of the United States

"The disadvantage of men not knowing the past is that they do not know the present. History is a hill or high point of vantage, from which alone men see the town in which they live or the age in which they are living."

-- G.K. Chesterton, *All I Survey* (1933)

In the Beginning (1790-1920)...

…there was no budget. None of the excerpts from the Constitution above mandated the submission of a budget to Congress by the Executive Branch. Instead, agencies individually lobbied Congress for funds. Congress appropriated

[1] Financial managers are defined, for this purpose, as naval officers carrying the 311x subspecialty code (financial management) and civil servants in the 5__ job series (budget analysts, accountants, auditors) or 343/346 series with significant financial responsibilities

by line item according to the agency request. For example, in 1799, Congress appropriated *“For the payment of rent for the several houses employed in the Treasury Department (except the Treasurer's office), two thousand seven hundred and thirty dollars and sixty-six cents…for expenses of firewood, stationery, printing, rent, and all other contingencies in the treasurer's office, six hundred dollars."* This worked fine so long as government was small and focused on essential functions. Congress dominated (Ways & Means Committee and Appropriation Committees were established), budget surpluses were common or the budget was at least balanced, and revenue primarily came from tariffs and duties. During periods of governmental stress (e.g., wartime), fiscal pressures drove some responses. For example, the Anti-Deficiency Act originates from legislation enacted in 1870. But for the most part, the financial affairs of the country were uncomplicated.

During this time the functions of government were limited to defense, international trade, expansion of the union, mediating (sometimes forcefully!) relations between the several states, and the operation of the three federal branches of government. Most of today’s social programs did not exist and they were considered improper functions of the federal government. To illustrate, note these quotes from two 19th century presidents when presented with legislation initiating welfare or social security – type programs:

> *"I cannot find any authority in the Constitution for public charity; [such spending] would be contrary to the letter and the spirit of the Constitution and subversive to the whole theory upon which the Union of these States is founded."* --President Franklin Pierce
>
> *"I feel obliged to withhold my approval of the plan to indulge in benevolent and charitable sentiment through the appropriation of public funds. ... I find no warrant for such an appropriation in the Constitution."* --President Grover Cleveland

Congress seeks Executive Leadership

By the early part of the 20th century, the country’s affairs became more complex. It was at this time that the United States was a continental size country with mounting responsibilities and bills. What the first two decades of the 20th century brought include deficits, war debts, an amended Anti-Deficiency Act (to include the process of apportionment), and an income tax was established. Budgeting and appropriating by individual agency proved unmanageable and Congress needed Presidential leadership over the process. The Budget and Accounting Act of 1921 was passed which established the Bureau of the Budget (what is now known as the Office of Management and Budget) in the executive branch and the General Accounting Office (now Government Accountability Office) in the legislative branch. This act required the submission of a consolidated federal budget each February. The legislature wanted the President to get control on spending and to present to the Congress a national view of spending priorities. All was well through the roaring 20s, taxes were reduced, the national debt was reduced, and the economy was flourishing with new technological innovations… until the bubble burst.

Great Depression, New Deal, World War II, and...

…there are deficits again! The Roosevelt administration ushered in a new paradigm of government responsibility. In response to the Great Depression, the federal government instituted jobs programs, the social security system, and other benevolent programs. Social spending began to take a sizable piece of the pie while revenues were still primarily coming from excise taxes, duties, and corporate taxes. This spending was in significant contrast to the prevailing view of the 19th century that such spending was not the purview of the federal government, but rather the responsibility of the states or the civil sector. The stress of the Great Depression moved public sentiment. World War II put further unprecedented stresses on the treasury and structural deficits became the norm from the 1950s on. A booming economy in the 1950s spurred by further advances in technology, led us to concentrate less on international and economic issues and more on the social problems in America. The Great Society programs of the 1960s signaled a further shift in the federal government's role. Simultaneously, the United States was "fighting" the Cold War.

Where Congress had major budget control from 1790-1920, the President had it since 1920 and the government grew in size and function. Spending grew accordingly. For much of this period, the appropriations committees of the House and Senate viewed their role as one of checking the spending sought by the Executive branch and the authorizing committees, but some believed the "Iron Triangle" of industry, authorizers and executive agencies was unhealthy and were looking for opportunities for change.

Increased Executive – Legislative tension

A series of issues resulted in severely strained relations between the executive and legislative branches in the early 1970s. President Nixon was charged with impounding appropriated funds. The 1973 oil embargo sent capital markets into a nose-dive touching off the worst bear market since the Great Depression and the country experienced a dreadful combination of high inflation, high interest rates, and high unemployment. This came at a time when the public expressed general distrust of government over our role in Vietnam and the Watergate scandal. One legislative response was the Congressional Budget & Impoundment Control Act of 1974…in short, Congress wanted control back. They established the Congressional Budget Committees, the Congressional Budget Office (CBO) and shifted the fiscal year to allow more time for deliberation of spending bills. The President's Budget was no longer considered draft legislation to be checked and approved by Congress, but more a suggestion or "opening bid" in a negotiation between the branches of government. Congress now had its own staff and process to build and legislate the budget. Despite this shift in power back to

Congress, fiscal troubles continued through the 1980s as the country faced record budget deficits during the waning years of the Cold War.

Plethora of new legislation:

To combat the rising deficits, several things were attempted. The Graham-Rudman-Hollings Acts I and II set deficit targets, but the targets were never achieved. The 1990 Budget Enforcement Act provided the pay-as-you-go feature for mandatory spending and caps on discretionary spending. It seemed to have a dampening effect and was extended in 1997 to provide these safeguards through 2002. The booming economy of the 1990s brought increased revenues which were further enhanced by reductions in discretionary spending and increased taxes. The budget was balanced from 1998 through 2002 (the first surplus budgets since 1969). A declining post-9/11 economy, tax cuts, and increased governmental spending have since eliminated the surpluses.

Also, during the 1900s, there was a renewed interest in the financial management aspects of government. Legislation was passed to improve government accountability and transparency and to implement New Public Management reforms. Such laws included the Chief Financial Officer (CFO) Act (1990), Government Performance and Results Act (1993), Government Management Reform Act (1994), the Federal Financial Management Improvement Act (1996), as well as executive branch initiatives such as the National Performance Review and the President’s Management Agenda. Among other things, these laws and directives require standardized accounting, performance plans, and the use of new technologies.

Chapter 2: From Congress to You

Overview

The Budget and Accounting Act of 1921 requires the President to submit a budget to Congress by the first Monday in February of each year. The creation of that budget will be discussed later in Chapter 6: Budget Formulation & Review. This chapter will examine the actions of Congress that create spending authority for the government. These actions include analyses by the CBO, the creation of a Congressional Budget blueprint by the Budget Committees, and the processes of authorization and appropriation. The chapter ends with a look at the flow of funds process: the delegation of spending authority from the enactment of the appropriation to the receipt of spending authority by the executive agency who will actually expend those dollars to perform programmatic functions.

The Congressional Actors

Before discussing the processes, it is important to first look at those who perform those processes, the congressional support offices and committees who enact the spending authority.

The Congressional Budget Office

Even before the President's Budget arrives in Congress, the CBO will provide the individual members and committees of Congress with their budget and economic outlook covering five and ten year horizons. This publication serves as a common basis for analysis of budget issues and fiscal policy discussion during that congressional session. Upon receipt of the President's Budget, the CBO provides an analysis of the President's proposals, focusing less on specific programmatic proposals and more on the underlying economic assumptions. This is normally completed within 6 weeks of receipt of the budget so that it may be considered by the budget, revenue, appropriation and authorizing committees. The CBO is supported by the other legislative staff agencies, such as the Congressional Research Service (CRS) and the Government Accountability Office (GAO).

Congressional Budget Committees

The Budget Committees in both houses of Congress each year prepare a resolution that outlines the fiscal boundaries for the federal government for the next several years[2]. These boundaries include revenue, budget authority, outlays, surplus or deficit amounts, and levels of public debt. The obligation and outlay authorities are allocated among the various budget functions[3] (see Figure

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[2] The time horizon considered in the resolution has ranged from just the budget year to 3-, 5-, 7-, 10- and even 15-year periods. Most recent resolutions have considered 5 or 10 years.
[3] Committee on the Budget, http://budget.house.gov/functions.shtml, updated Sep 2010.

1 - Budget Functions). These allocations limit the scope of the appropriations bills. Likewise, the revenue and debt limitations affect the revenue committees. The budget committee endeavors to be completed with the resolution by April 15th each year to permit time for the spending and revenue committees to complete their work before the start of the new fiscal year on October 1st. There has been a marked trend of increasing detail and specificity in the budget resolution which tends to constrain the authority of the other congressional committees.

050 National Defense	550 Health
150 International Affairs	570 Medicare
250 Space, Science & Technology	600 Income Security
270 Energy	650 Social Security
300 Natural Resources and Environ.	700 Veteran's Benefits
350 Agriculture	750 Justice
370 Commerce and Housing Credit	800 General Government
400 Transportation	900 Net Interest
450 Community/Regional Development	920 Allowances
500 Education, Training, Employment & Social Services	950 Undistributed Offsetting Receipts
	970 Overseas Deployments & Other

Figure 1 - Budget Functions

Congressional Authorization Committees

Before appropriations are legally available for obligation, the programs or agencies they fund should be authorized by law. Many of the commonly known congressional committees are authorizing committees, for example the House and Senate Armed Services Committees are the authorizing committees for national defense budgets. In the case of the defense department, these committees not only authorize the programs, they fulfill the constitutionally defined functions of the legislature in Article I, Section 8:

> *To raise and support armies; To provide and maintain a navy; To make rules for the government and regulation of the land and naval forces; To provide for calling forth the militia to execute the laws of the Union, suppress Insurrections and repel Invasions; To provide for organizing, arming, and disciplining, the militia, and for governing such part of them as may be employed in the service of the United States…*

Often members of the Department of Defense criticize Congress of meddling or interfering in the operation of the Department. Constitutionally, it's Congress' responsibility. This is the committee - and the authorization bill its primary tool - that defines such policy as military pay raises, the size of the force, authorizes new procurement programs, and decides matters of policy (e.g., combat roles for women). In fact, the authorization committee permits the function to exist, they define upper and lower limits to its scope of operations, and define the time period during which it will exist.

Congressional Appropriations Committees

Given the authorization of a program or agency, the appropriations committees will provide the actual budget authority with which they will operate. While there are many authorization committees for the various functions of government, there is only one appropriations committee in each house of Congress. These committees produce a total of 13 annual appropriations bills each year that cover all the various budget functions. The two most important for DoD are the National Defense Appropriations bill which provides authority for operations & maintenance, personnel, and procurement, and the Military Construction bill which provides authority for construction projects and military family housing.

The Committee Processes & Products

Figure 2 - The Congressional Processes[4] shows the processes through which the three types of committees described above produce their primary outputs. Shortly after the President submits his budget to Congress, each of the committees conduct hearings at which executive branch leadership will testify regarding the contents of the budget. These hearings also include the voice of industry, independent analysts, congressional staff members (e.g., from CBO, GAO, or CRS), labor unions, and the like. The administration will justify and defend the budget request before supporters and critics alike. This testimony, taken in consideration with the CBO analysis and the interests of constituents, the political party leadership, and the needs of the nation will drive the shape and size of the appropriations bills. Simply put, the hearing process is Congress' way of educating themselves on the issues at hand, much like how a budget analyst would ask questions to the end user or customer of the programs they support.

As noted above, the Budget Committees produce a Budget Resolution. A resolution is just that…it expresses the resolve of Congress to adhere to an approved plan. It is one of three pieces of legislation that comes out of the Congressional budget process. However, it does not get signed by the President and become law. The authorization and appropriating committees, however,

[4] U.S. Senate, Committee on the Budget, http://budget.senate.gov/republican/analysis/budgetprocess.pdf - Sep 2010

produce bills, which do become law and require Presidential signature. The Budget Resolution certainly influences the scope and nature of the deliberations of the authorizing and appropriation committees; further, the authorization and appropriation committees influence each other. Depending on the political strength of each committee, appropriators may cause programs to be authorized that ordinarily might not have and vice-versa.

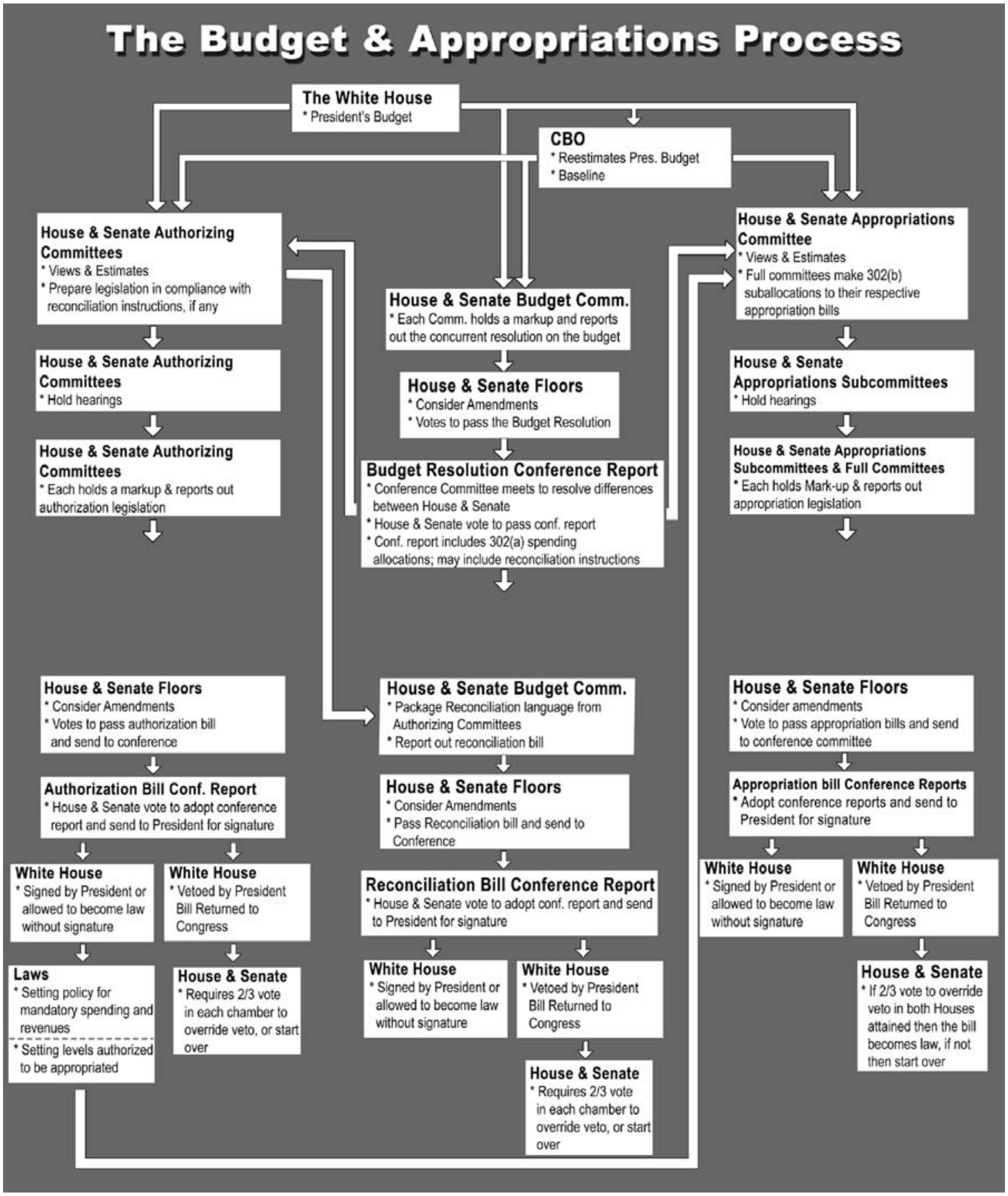

Figure 2 - The Congressional Processes

Figure 3 - Traditional Congressional Budget Calendar
shows the traditional, or perhaps ideal, flow of events and timeline for their completion.

Date	**Action**
First Monday in February	President submits budget to Congress.
February 15	Congressional Budget Office submits economic and budget outlook report to Budget Committees.
Six weeks after President submits budget	Committees submit views and estimates to Budget Committees.
April 1	Senate Budget Committee reports budget resolution.
April 15	Congress completes action on budget resolution.
May 15	Annual appropriations bills may be considered in the House, even if action on budget resolution has not been completed.
June 10	House Appropriations Committee reports last annual appropriations bill.
June 15	Congress completes action on reconciliation legislation (if required by budget resolution).
June 30	House completes action on annual appropriations bills.
July 15	President submits mid-session review of his budget to Congress.
October 1	Fiscal year begins.

Source: Section 300 of the Congressional Budget Act of 1974, as amended (P.L. 93-344, 2 U.S.C. 631).

Figure 3 - Traditional Congressional Budget Calendar[5]

Congressional Oversight of Defense

Since the Republic was founded, there has been an ongoing debate over the boundary lines separating the legislature from the executive regarding the power to commit the military and the power of the purse. Federalist Paper 51 speaks eloquently on the need for checks and balances between the branches of government. We've seen in our lifetimes (depending on how old you are!), this struggle played out in the National Security Act of 1947, the War Powers Resolution of 1973, the Goldwater-Nichols Act of 1985, the Line Item Veto Act of

[5] Heniff Jr,, Bill, "The Congressional Budget Process Timetable," Congressional Research Service, March 20, 2008

1983 and others. Contemporary writers (political scientists and practitioners alike) have described the reasons why Congress oversees – even micromanages – the defense department, how they do it, and whether the effects are good or bad. Some say they do it too frequently and should delegate more authority, others claim Congress has abdicated its authority and should do more.[6]

For the DoD financial manager, this debate may seem academic, but the effects are real and must be acknowledged and managed. In short, the reasons why Congress takes such an active interest in DoD can be summarized as:

- Legal prerogative under Article I, Sections 8 and 9 of the Constitution
- Sense of duty where Congress believe their judgment is better than DoD
- In an effort to shape policy
- Response to media amplified allegations about DoD mismanagement
- Greatest opportunity to affect federal discretionary spending through the defense budget since it is the largest component of the discretionary budget appropriated annually
- Partisan and congressional-executive branch competition and occasional mistrust
- Ambition – to gain or retain power
- Advocacy or protection of constituent interests, e.g., military installations, labor, defense contractors

The means by which they exercise such control include:

- Line item adjustments to the budget
- Formal communication in the form of congressional hearings
- Informal communication with DoD staff outside of hearings
- Requirements placed on program execution
- Reporting requirements
- Reprogramming and transfer restrictions
- Earmarks
- Reviews, audits, and investigations by committee staffs, GAO, and CRS
- Restrictions on funds pending compliance with provisions of law or committee reports.

An example of such controls can be seen on the next page. Figure 4 - Congressional Oversight Example is from the FY2008 Defense Appropriation bill, annotated with examples of Congressional oversight and control tools. It is a good representation of what is in the Appropriations bill each year.

[6] This literature is summarized in Candreva, P. and L. R. Jones, “Loosening The Purse Strings: Congressional Delegation of Authority in the Case of the Defense Emergency Response Fund”, unpublished manuscript, September 2004.

Excerpts from Fiscal Year 2008 Defense Appropriation Bill (PL 110-116)

Execution Requirement

SEC. 8004. No more than 20 percent of the appropriations in this Act which are limited for obligation during the current fiscal year shall be obligated during the last 2 months of the fiscal year: *Provided,* That this section shall not apply to obligations for support of active duty training of reserve components or summer camp training of the Reserve Officers' Training Corps.

SEC. 8096. The Secretary of Defense may transfer funds from any available Department of the Navy appropriation to any available Navy ship construction appropriation for the purpose of liquidating necessary changes resulting from inflation, market fluctuations, or rate adjustments for any ship construction program appropriated in law: *Provided* , That the Secretary may transfer not to exceed $100,000,000 under the authority provided by this section: *Provided further* , That the Secretary may not transfer any funds until 30 days after the proposed transfer has been reported to the Committees on Appropriations of the House of Representatives and the Senate, unless a response from the Committee is received sooner: *Provided further* , That the transfer authority provided by this section is in addition to any other transfer authority contained elsewhere in this Act.

Transfer Restriction

Reporting Requirement

SEC. 8097. (a) The total amount appropriated or otherwise made available in title II, III and IV of this Act is hereby reduced by $506,900,000 for contractor efficiencies.

General Reduction

(b) The Secretary of Defense shall allocate this reduction proportionately to each budget activity, activity group, subactivity group, and each program, project, and activity within each applicable appropriation account.

Reduction Requirement

Program Requirement

SEC. 8103. Up to $12,000,000 of the funds appropriated under the heading, `Operation and Maintenance, Navy' may be made available for the Asia Pacific Regional Initiative Program for the purpose of enabling the Pacific Command to execute Theater Security Cooperation activities such as humanitarian assistance, and payment of incremental and personnel costs of training and exercising with foreign security forces: Provided, That funds made available for this purpose may be used, notwithstanding any other funding authorities for humanitarian assistance, security assistance or combined exercise expenses: Provided further, That funds may not be obligated to provide assistance to any foreign country that is otherwise prohibited from receiving such type of assistance under any other provision of law.

Earmark

SEC. 8032. (a) IN GENERAL- Notwithstanding any other provision of law, the Secretary of the Air Force may convey at no cost to the Air Force, without consideration, to Indian tribes located in the States of North Dakota, South Dakota, Montana, and Minnesota relocatable military housing units located at Grand Forks Air Force Base and Minot Air Force Base that are excess to the needs of the Air Force.

Execution Requirement

SEC. 8033. During the current fiscal year, appropriations which are available to the Department of Defense for operation and maintenance may be used to purchase items having an investment item unit cost of not more than $250,000.

SEC. 8066. The Secretary of Defense shall provide a classified quarterly report beginning 30 days after enactment of this Act, to the House and Senate Appropriations Committees, Subcommittees on Defense on certain matters as directed in the classified annex accompanying this Act.

Monitoring & Oversight

Figure 4 - Congressional Oversight Example

The Flow of Funds

Appropriations and authorization bills provide the authority for executive branch agencies to purchase goods and services and expend funds from the Treasury in the advancement of agency objectives. Congress, through the power of the purse, sets limits on the use of those funds. As will be shown in Chapter 7 – Appropriated Funds, Congress regulates what will be done, when it will be done, and to what level of effort through their exercise of control over the purse. Funds are limited, restricted, earmarked, and otherwise designated. Not all managers in the executive branch are expected to know all these rules so a process has been established to ensure that funds are used as intended. We call this process the Flow of Funds.

The Process

Once Congress has appropriated funds and the President signs the appropriation into law, the spending authority must be transferred to those in the agencies who will obligate the government to make payments from the Treasury. This section will examine that process.

The first step in the process is the issuance of an *appropriation warrant* by the Treasury to the Office of Management and Budget (OMB). This is analogous to opening a checking account at your bank or credit union. The Treasury opens the appropriation accounts so that payments of public funds can be traced back to the appropriated purpose and dollar limitations are defined in accordance with the language of the appropriations bill.

One of the functions assigned to the OMB shortly after it was created is to serve as a regulator of the rate of spending. The objective is to minimize the possibility of supplemental or deficiency (hence, the title, Anti-Deficiency Act) appropriations and to use funds as economically and efficiently as possible. OMB performs this function by **apportioning** funds to the various agencies. Simply put, apportionment is a plan. It is a process whereby the spending authority is provided to the agency in a periodic fashion based upon the actual needs of the agency. OMB Circular A-11, part 4, governs apportionment.

Additionally, as part of apportionment, the law[7] allows for the establishment of a reserve but only a) to provide for contingencies; b) to achieve savings made possible by or through changes in requirements or greater efficiency of operations; or c) as specifically provided by law. For the Department of the Navy, Reserve funds are authorized further in paragraph 073100 of the DoN Financial Management Policy Manual, NAVSO P-1000.

The agency will formally request apportionment at a rate suggested by the programs in the budget and historical spending patterns. Funds may be

[7] 31 USC sect 1512(c)

apportioned over time, by program, project, object, activity or some combination of. Generally, annual appropriations are apportioned on a quarterly basis; multi-year appropriations are apportioned annually. OMB normally does not subdivide the appropriation by programs or organizational levels but relies on the agency heads to do that. Agencies may request reapportionment at any time to reflect fact-of-life changes from budgeted plans.

Apportionments are subject to 31 US Code 1517 restrictions for over obligation just as the entire appropriation is subject to the Anti-Deficiency Act. In fact, most violations of the Anti-Deficiency Act result from spending in excess of the apportionment, not overspending the appropriation as a whole.

Upon receipt of the apportionment, the Undersecretary of Defense (Comptroller) (USD-(C)), will ***allocate*** the authority among the services to their respective Assistant Secretaries for Financial Management and Comptroller (e.g., ASN(FM&C) for the Department of the Navy). The service secretary further allocates to the heads of operating agencies. The Department of the Navy refers to these agencies as the Responsible Officer (RO). Specifically, it is the Chief of Naval Operations (CNO), Commandant of the Marine Corps (CMC), and the Director of Naval Research (DNR). A primary objective of allocation is to ensure that the intent of Congress is met in the use of the funds. DoD Financial Management Regulation (FMR) Volume 14, Chapter 1 governs the DoD process.

The RO then further distributes the spending authority to the Major Commands (MAJCOM) in the form of an **operating budget** (for expense-type appropriations) or an **allotment** (for investment type appropriations). Normally, operating budgets and allotments are provided with the responsibility to comply with the Anti-Deficiency Act (31 US Code 1517)[8], however that is not required. For example, the Pacific Fleet commander routinely passes 1517 responsibility to the three Type Commanders, but the Atlantic Fleet commander does not. Several factors influence this decision and are impacted by it including the size and capabilities of the various staffs, the level and frequency of communication between staffs (all U.S. Atlantic Fleet (LANTFLT) staffs are in Norfolk, the U.S. Pacific Fleet (PACFLT) staffs are dispersed), management preferences and even tradition.

These activities will further subdivide the spending authority down the chain of command to the end user level. There may be few or many subdivisions below the MAJCOM level. These further subdivisions are called **operating targets (OPTAR), allowances or expense limitations**. These terms represent planning estimates and do not carry 1517 responsibility. For example, a ship will be granted a OPTAR of O&M,N funds, but the ship's commanding officer does not hold 1517 responsibility; the type commander or fleet commander retains that responsibility. This does not mean that a ship's Commanding Officer (CO) would spend without concern for exceeding his OPTAR. However, it is entirely possible

[8] The requirements of the Anti-Deficiency Act are defined in Chapter 7.

that a ship CO could exceed his OPTAR while a different ship under the same fleet commander has excess OPTAR. The fleet commander would be responsible for managing the 1517 responsibility in that case. Figure 5 shows a notional example of the flow of funds. Obviously, not every chain of command can be accounted for the intent of the guidance, terms, and concepts are depicted in this example.

Figure 5 - Example Flow of Funds shows an example flow of funding authority.

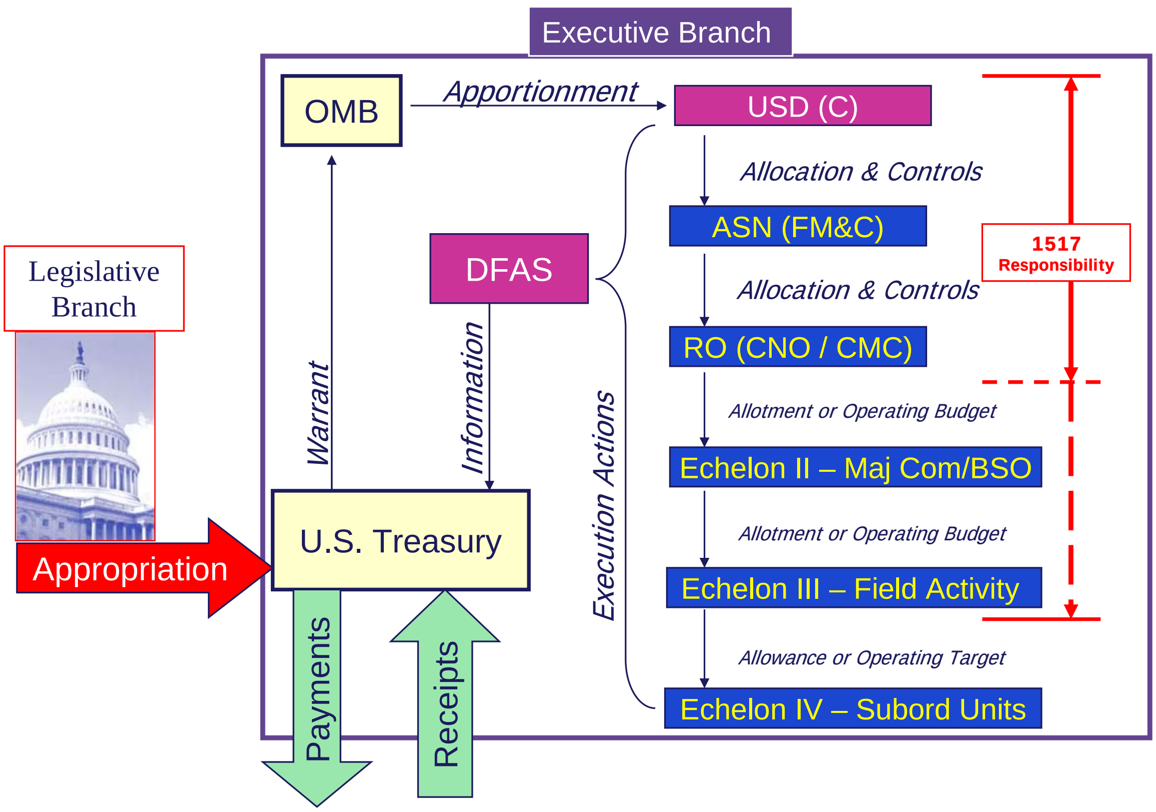

Figure 5 - Example Flow of Funds

Funding Architecture

Along with the flow of spending authority comes the flow of spending restrictions. All appropriations come "with strings attached" that reflect the intent and limitations imposed by the authorizing and appropriating legislation. As the authority flows down the chain of command, it is accompanied by explanatory text that ensures the intent of congress is met.

Architectural terms are used to describe some of these restrictions. A *floor* represents the minimum level of spending for a particular purpose. A *ceiling* represents a maximum level. A *fence* represents funding protected from being used for another purpose. However, Congress can use these terms for a variety of reasons.

Historically, floors have been set for items such as maintenance accounts for real property, ceilings are imposed on activities like renovations to flag and general officer quarters, and fences surround quality of life initiatives such as child development centers. Fences are usually identified by Congress in specific language and usually limit funds for a particular purpose. Fencing language usually does not permit transfers into or out of the particular account. Good examples of fenced funds are intelligence funding or counter-drug funding. These funds are specifically identified in language, allow for use specific use of the funds, and do not permit moving of funds into or out of the account.

While Congress may apply legal limitations on funds, other restrictions not subject to legal limitations may be imposed by the grantor of funds. There are a variety of reasons why a grantor might do this but it should be limited to situations where normal management type reporting cannot accomplish the desired control of expenses.[9]

[9] NAVSO P-1000, para 073200 6.b

Chapter 3: A Look at the Federal Budget

Overview

This chapter briefly examines the entire federal budget to understand the defense budget in the context of all government spending and revenue, in the past and projected for the future. In Chapter 1, we examined the historical context in which we operate; this chapter provides the financial context. Some of the questions this chapter attempts to answer are: How large is the defense budget in proportion to other government activity? How has that changed over time? What factors exert pressure on the DoD funding top line?

The last chapter noted that there are 21budget functions in the federal government. But a list of functions gives no indication of their relative size. Figure 6 - Budget Functions and Budget Functions Sorted by Size below displays those 21 functions and the amounts for each as presented in the Fiscal Year 2010 President's Budget. The table on the left displays the budget by function then sorts those functions in descending order of their size (as reflected in budget authority) in the table on the right.

	Function	$B
050	National Defense*	722.1
150	International Affairs	67.4
250	Space & Science	31.0
270	Energy	8.8
300	Natural Resources & Environment	39.5
350	Agriculture	25.4
370	Commerce	-111.8
400	Transportation	93.7
450	Community Development	19.9
500	Education & Training	91.9
550	Health Care	386.4
570	Medicare	462.1
600	Income Security	664.6
650	Social Security	723.5
700	Veterans' Benefits	125.0
750	Justice	53.5
800	General Government	29.0
900	Net Interest	187.8
920	Allowances	60.5
950	Undistributed Receipts	-79.7
970	Overseas deployments & other	0.0
	Total	3600.6

	Function	$B
650	Social Security	723.5
050	National Defense*	722.1
600	Income Security	664.6
570	Medicare	462.1
550	Health Care	386.4
900	Net Interest	187.8
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400	Transportation	93.7
500	Education & Training	91.9
150	International Affairs	67.4
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750	Justice	53.5
300	Natural Resources & Environment	39.5
250	Space & Science	31.0
800	General Government	29.0
350	Agriculture	25.4
450	Community Development	19.9
270	Energy	8.8
970	Overseas deployments & other	0.0
950	Undistributed Receipts	-79.7
370	Commerce	-111.8
	Total	3600.6

Figure 6 - Budget Functions and Budget Functions Sorted by Size

One can clearly see that the bulk of the federal budget is in a handful of budget functions. Social Security, National Defense, Income Security and medical related items comprise over 82% (compared to 78% in 2009) of the annual budget request. Adding interest on the national debt brings the total over 87%.

Discretionary and Mandatory Spending

It’s important to note that there are two categories of spending in the annual budget to Congress. The first category is *discretionary* spending. Items of expense in this category include those functions of government that are financed through the 13 annual appropriations bills. That is, if Congress does not pass authorizing and appropriating legislation, those functions would not occur. Recall the government shut down in 1996 in the absence of appropriations bills or a continuing resolution authority. Items in the discretionary budget include national defense, education, transportation, justice, agriculture, and general government.

The second category of spending is *mandatory* spending, sometimes incompletely referred to as entitlement spending. This category includes all items of expense that do not require annual authorization or appropriation. The expenditure of funds on these items is provided in permanent law. There may be annual changes to that law, but absent those changes, expenditures would still occur if the appropriate triggering mechanism were activated. Items in this category include Social Security, veteran’s benefits, federal employee pensions, interest on the national debt, Medicare and Medicaid, and unemployment benefits.

Figure 7 - FY2010 Federal Budget - Categories of Spending displays the 20 budget functions consolidated into broad categories of both discretionary and mandatory spending. Noteworthy is the fact that slightly less than two-thirds of the federal budget is in the mandatory spending category. This is a significant change from just a few decades ago.

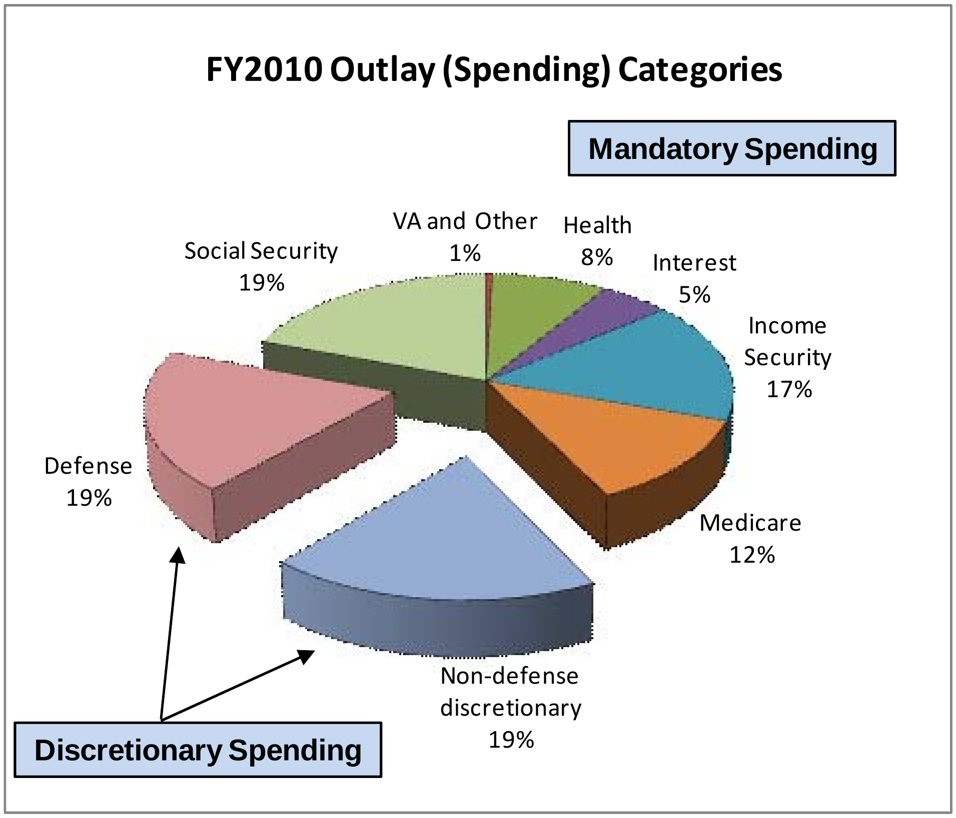

Figure 7 - FY2010 Federal Budget - Categories of Spending

Trends in Federal Spending

Figure 8 - Mandatory vs. Discretionary Spending shows the change in these categories over the past 40 or so years. Percentages reflect the percentage of total federal outlays as portrayed in the 2010 President's Budget. To put some historical reference points in the discussion, recall that 1960 was the height of the Cold War and approximately the time when the DoD's resource allocation system, now known as PPBE, was introduced. Note that the relative proportions of defense spending and payments to individuals have nearly reversed… other budget categories have remained relatively stable. The graph represents a yearly trend from 1968 to the projected year 2018.

Figures are % of outlays	**1968**	**2010**
Payments to Individuals	28%	57%
Interest on the debt	6%	5%
Defense	46%	19%
Other Discretionary	20%	19%
Mandatory:Discretionary	34:66	62:38

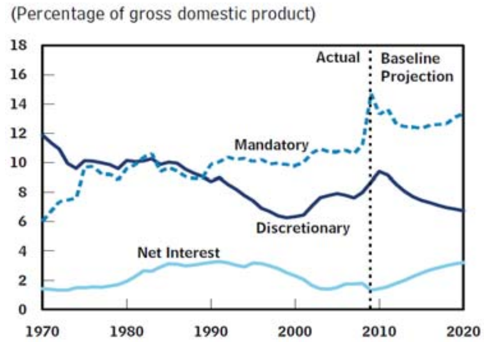

Figure 8 - Mandatory vs. Discretionary Spending (source: CBO)

It's also important to understand what the projections are for these trends. Will mandatory spending continue to be a larger share of overall spending or will the trend reverse and discretionary spending become more common again? There are implications for DoD. It's difficult to tell but considering the bubble from retiring baby boomers and the increased demand they will add to the already expensive Medicare system, one might conclude that the trend will not reverse without major policy changes. This is one of the issues that Congress is struggling with right now.

A significant source of power for Congress is the power of the purse. One means of affecting constituent interests is through the exercise of that power. Often, the best place is in the annual discretionary spending bills. Defense spending is the largest category of discretionary spending, so it is an attractive vehicle for policy setting, even in non-defense areas. Historically, during each session of Congress, there are between 7,000 and 9,000 bills that get introduced. Roughly, 3-5%, or 210-450, actually gets signed into law. That said, the one spending bill that gets signed every year is the defense appropriation bill, which makes it very attractive for Congress to assert their power and special interests. In recent years, the defense supplementals have been a prime target of opportunity for Congress. Looking forward, if discretionary budgets become relatively smaller, the opportunities for congress to exercise the power of the purse may become more limited and each change more influential.

(Percent)

	Actual		Projected[a]		
	1999–2008	2009	2010	2011	2012–2020
Mandatory spending	6.4	31.2	-8.0	8.3	4.7
Social Security	5.0	10.7	3.4	3.6	5.7
Medicare	8.0	9.4	3.9	8.0	5.8
Medicaid	7.1	24.6	8.7	1.3	7.8
Other mandatory outlays[c]	6.7	104.4	-34.9	20.6	-1.0
Discretionary spending	7.5	9.1	9.7	3.4	1.6
Defense	8.5	7.2	5.3	4.5	2.2
Nondefense	6.4	11.2	14.7	2.3	1.0
Net interest	0.5	-26.1	8.3	11.0	14.8
Total Outlays	**6.1**	**17.9**	**-0.9**	**6.6**	**4.5**
Total Outlays Excluding Net Interest	**6.8**	**22.0**	**-1.4**	**6.3**	**3.5**

Figure 9 - Projected Spending Growth Rates

Figure 9 - Projected Spending Growth Rates shows the CBO's projections for growth in each of the various categories of spending over the next ten years. If one were to assume these rates of growth are correct, then one could multiply the FY10 President's Budget by those growth rates to project the FY18 budget. Figure 10 - FY2020 Budget Based on CBO Growth Rates is that projection. One can see National Defense falls to third position. This is actually a slight improvement compared to the most recent budgets. Note that total federal spending exceeds $4 trillion.

Function	FY10$B	FY20$B
650 Social Security	723.5	1,259.5
050 National Defense	722.1	897.6
570 Medicare	462.1	812.1
600 Income Security	664.6	1,146.0
550 Health Care	386.4	818.9
900 Net Interest	187.8	746.6
700 Veterans' Benefits	125.0	113.0
500 Education & Training	91.9	101.5
400 Transportation	93.7	103.5
750 Justice	53.5	59.1
150 International Affairs	67.4	74.5
300 Natural Resources & Environment	39.5	43.6
250 Space & Science	31.0	34.2
800 General Government	29.0	32.0
350 Agriculture	25.4	28.1
370 Commerce	-111.8	-123.5
450 Community Development	19.9	22.0
270 Energy	8.8	9.7
920 Allowances	60.5	66.8
950 Undistributed Receipts	-79.7	-88.0
Total	3,600.6	6,157.3

Function	FY20$B
650 Social Security	1,259.5
600 Income Security	1,146.0
050 National Defense	897.6
550 Health Care	818.9
570 Medicare	812.1
900 Net Interest	746.6
700 Veterans' Benefits	113.0
400 Transportation	103.5
500 Education & Training	101.5
150 International Affairs	74.5
920 Allowances	66.8
750 Justice	59.1
300 Natural Resources & Environment	43.6
250 Space & Science	34.2
800 General Government	32.0
350 Agriculture	28.1
450 Community Development	22.0
270 Energy	9.8
950 Undistributed Receipts	-88.0
370 Commerce	-123.5
Total	6,157.3

Figure 10 - FY2020 Budget Based on CBO Growth Rates

Federal Revenue

It is also useful to look at the source of the funds that will be spent. How much of today's $3.7 trillion in spending comes from our income taxes, how much from other sources of revenue? Figure 11 - Sources of Federal Revenue since 1966 (Source: CBO) shows that the largest portion of federal revenue derives from your Income Taxes - the Federal Income Tax Withheld (FITW) line on your Leave & Earnings Statement (LES).

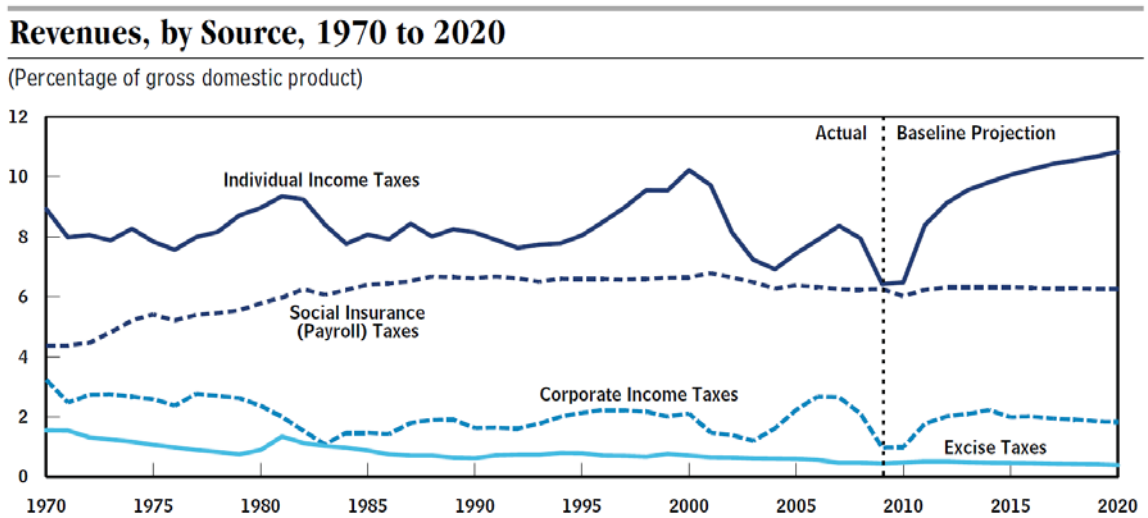

Figure 11 - Sources of Federal Revenue since 1966 (Source: CBO)

The next largest, and growing, share is Social Security taxes – the FICA line on your LES. Corporate taxes, tariffs, excise taxes and the like have declined in relative terms. If spending will rise to over $6 trillion over the next decade, will the sources of revenue need to shift? Figure 11 suggests that income taxes will make up the difference, based on economic growth projections. Of course, these are projections. Will the various sources of revenue resist and put downward pressure on federal spending? If there is downward pressure, where will the President and Congress cut? Medicare? Social Security? Defense? Homeland Security? Justice?

We should also look at the relationship between revenue and spending. We call that difference the budget surplus or the deficit (depending on which is greater).

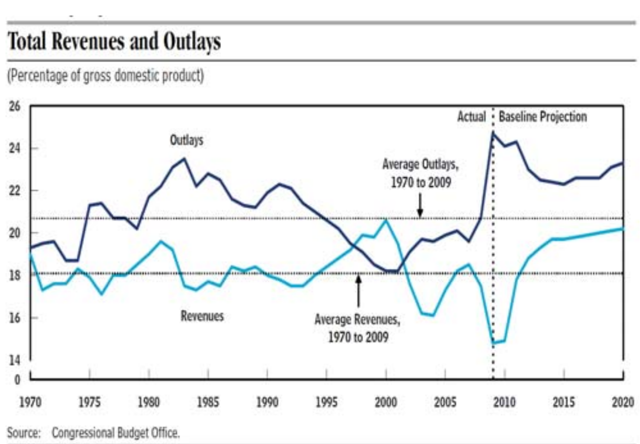

Figure 12 - Deficits and Surpluses (Source: CBO)

Since WWII, the U.S. has suffered from structural deficits. In the last 40+ years, there was a budget surplus only five times: 1969, and 1998-2001. Figure 12 - Deficits and Surpluses shows the relationship between revenues and outlays for that 40 year period. One can see clearly the effect of the booming economy and tax increases of the 1990s and the tax cuts and 9/11 effect in the early 2000s.

DoD's Share of Federal Spending

Another useful historical perspective is to examine that portion of the economy the country devotes to national defense. If one were to consider the spending on national defense as analogous to an insurance policy for the country, one could ask, "what percentage of the country's volume of activity (in dollar terms) should be spent to secure itself?" The often used metric is the percentage of Gross Domestic Product (GDP) spent on national defense. Gross Domestic Product is the dollar value of the economic transactions of the country in a year. Figure 13 - Defense Spending as a Percentage of GDP shows how the percentage of GDP spent on defense has declined over the years to a low of 2.9% in 2000. It is now approximately 5%.

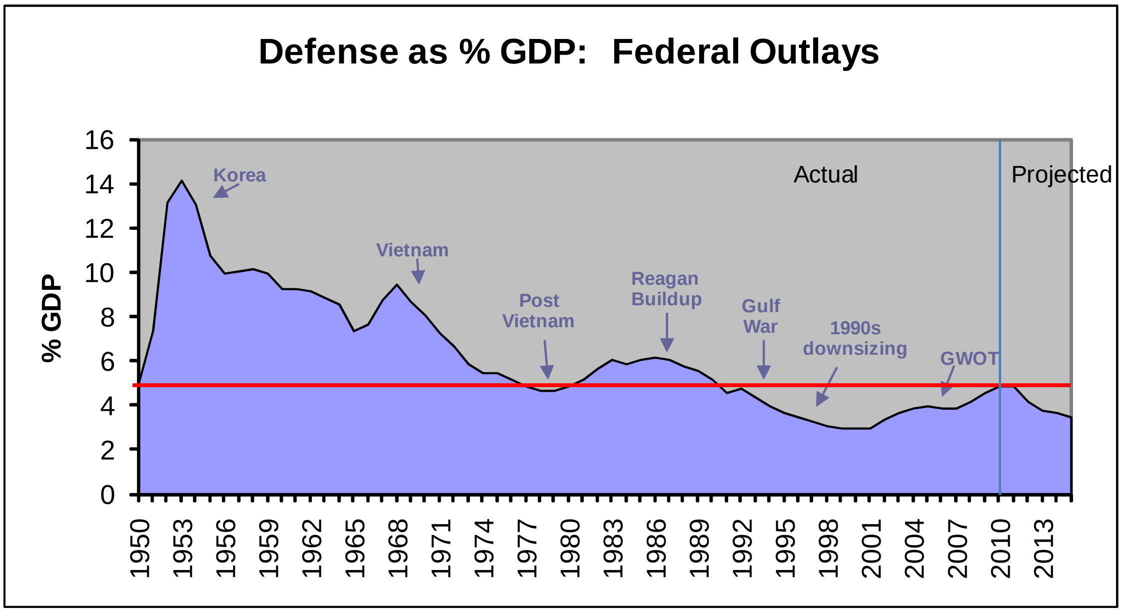

Figure 13 - Defense Spending as a Percentage of GDP

In addition to defense's share of the economy, we can also look at what has been the trend in defense spending in absolute and inflation-adjusted terms. In Figure 14 - Defense Spending, 1946-2013, we can see that there has been consistent and steady growth in defense spending since the end of the WWII. How much of that growth is inflation-related? When the data are normalized to constant FY2005 dollars, we see that the defense spending has been rather cyclical since the mid-1950s. There are peaks at about $500 billion and valleys at about $300 billion every 15 years or so. Should the trend hold (and there is no reason to suspect it will), we are nearing another peak.

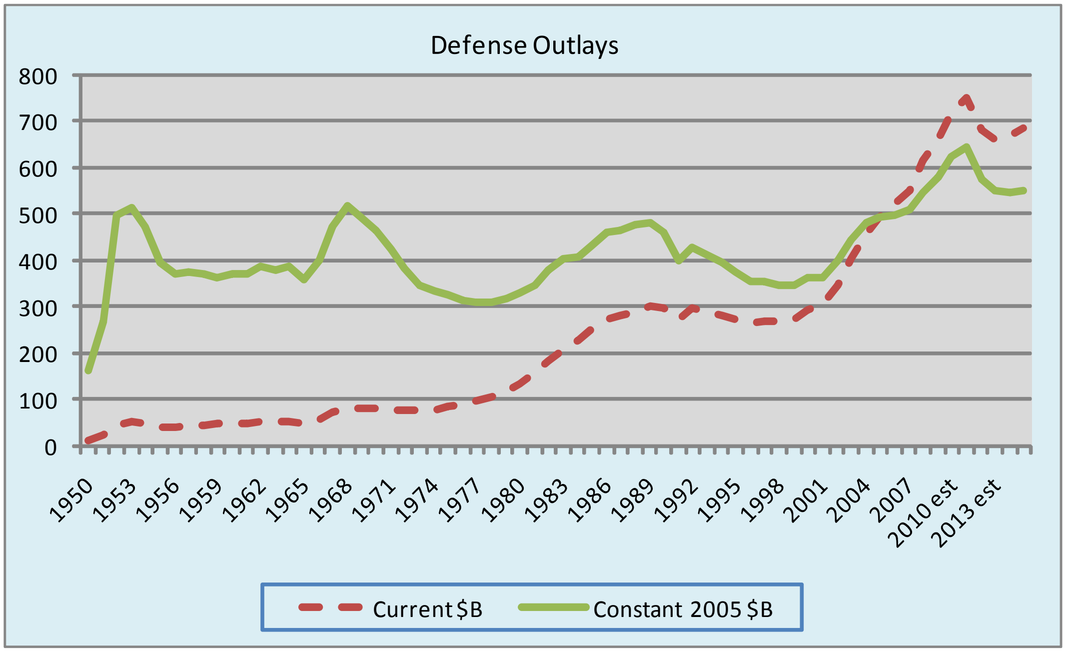

Figure 14 - Defense Spending, 1946-2013

Let us now look at the components of the defense budget, how the funds are distributed by service and by appropriation. We see that the services have enjoyed a fairly consistent proportion of the overall defense budget over time.

The share of defense spending for each branch of service is displayed in Figure 15 - Defense Budget by Service, 1980-2015. The common belief that the services share the budget 1/3 each is not true. The Navy and Air Force currently enjoy about 30% of the DoD budget, the Army 25% and the defense-wide agencies about 15%. Projections across the FYDP show a slight reduction for the Navy and Air Force while the Army and DoD grow slightly.

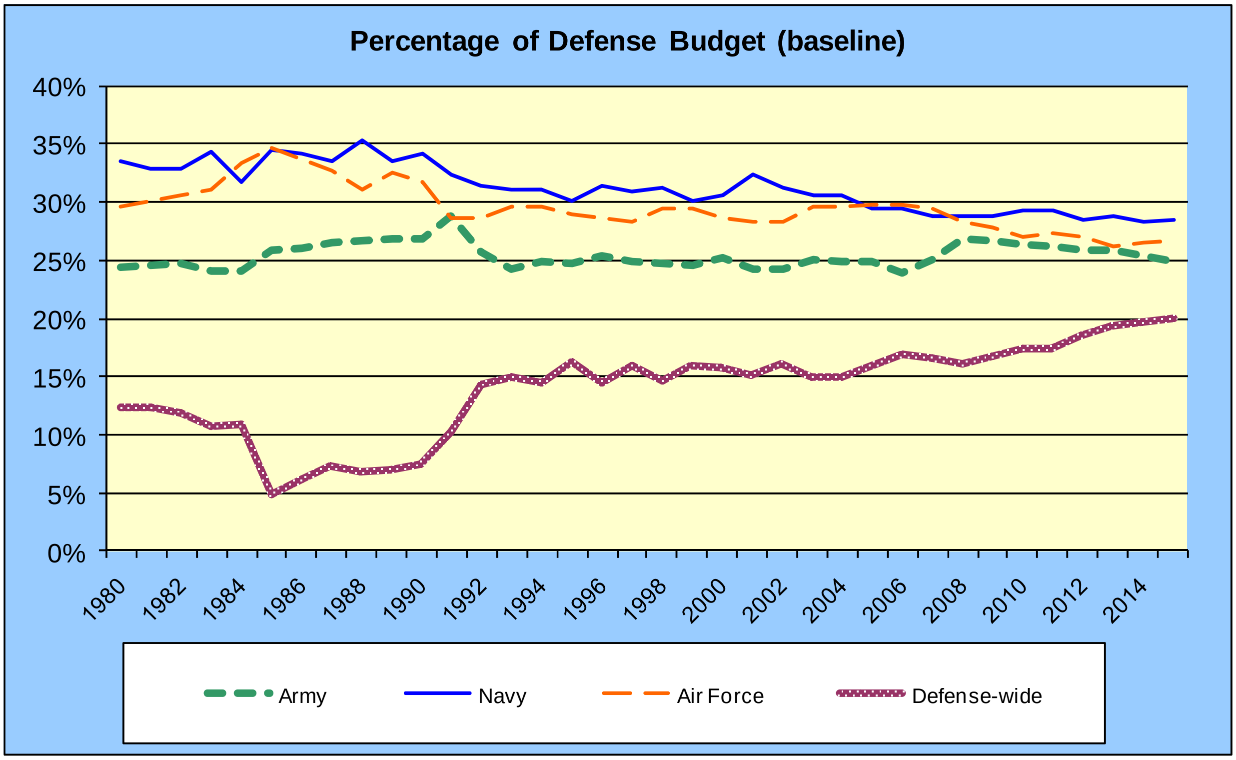

Figure 15 - Defense Budget by Service, 1980-2015

It's interesting to think of the historical consistency and how the recent supplemental funding has impacted service spending. Figure 16 - Defense Budget by Service Including Supplementals, 1980-2015, shows a distinct difference in spending patterns. The difference can be attributed largely to the ground war in Iraq.

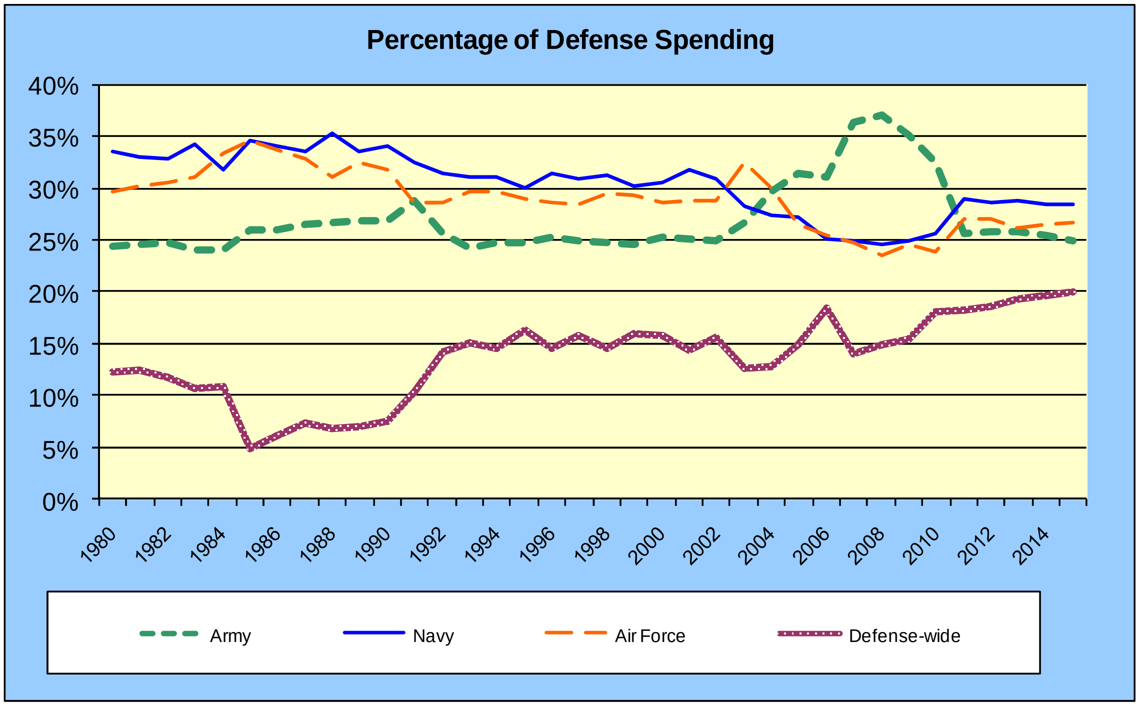

Figure 16 - Defense Budget by Service Including Supplementals, 1980-2015

Lastly, it helps to understand DoD finances by looking at how much is spent by appropriation.

Figure 17 - DoD Budget Authority by Appropriation Type– shows plainly that Operations and Maintenance and Military Personnel are the two largest families of appropriations. Since O&M covers most of the DoD civilian salaries, clearly people are the biggest cost element for DoD, not the procurement or operation of weapons systems. (Of course, some of those people are supporting weapons systems acquisition and operations, but that is a managerial accounting question, not a funds accounting question – a topic that will be covered in the accounting chapter.) Also noteworthy is that accounts which can be contentious such as Military Construction and Family Housing are relatively minor portions of overall defense spending.

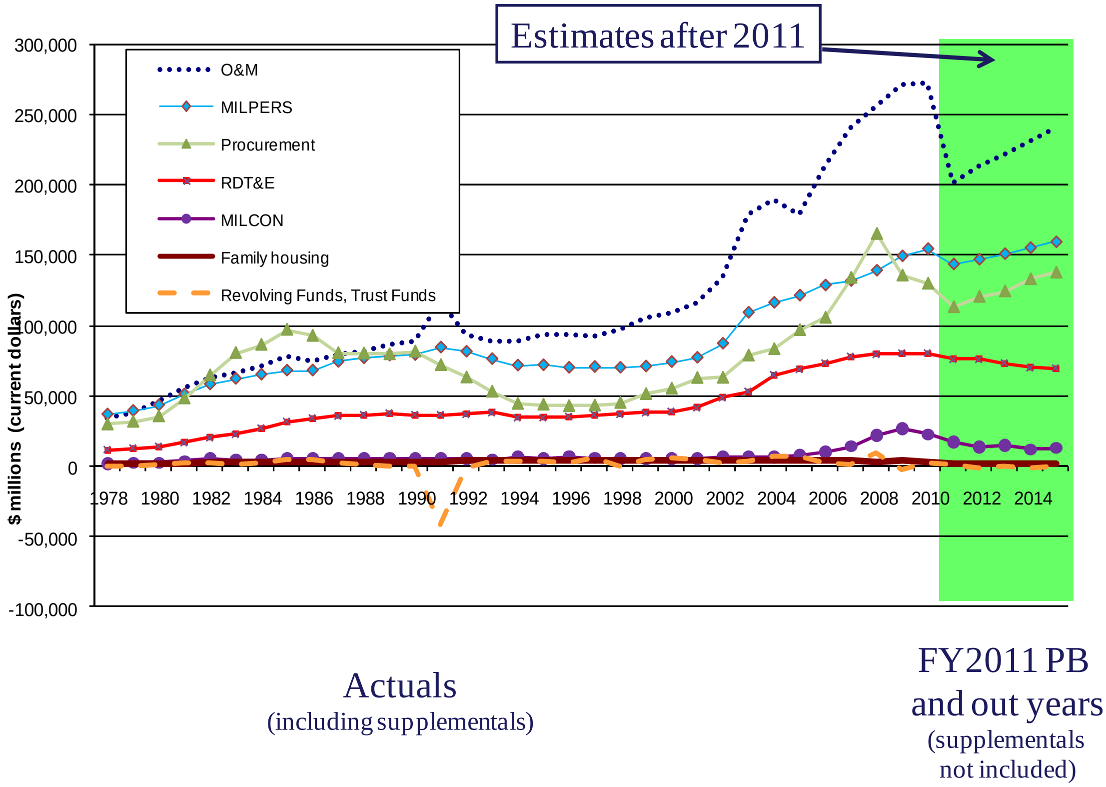

Figure 17 - DoD Budget Authority by Appropriation Type

Chapter 4: Department of the Navy Financial Organization

Overview

This chapter looks at the organizational structure of the Department of Defense that supports the Planning, Programming, Budgeting & Execution (PPBE) and financial management processes. It is presumed that most students already have a basic understanding of the structure and functions of the Department of Defense. Specifically, it is expected that the reader understands the basic roles and functions of the offices of the Secretary of Defense, Combatant Commanders, Service Secretaries, Joint Chiefs of Staff, and Service Chiefs as well as the objectives of the Goldwater-Nichols DoD Reorganization Act of 1986. This chapter will focus primarily on the *financial management* roles of these and subordinate offices.

Secretary of Defense

The Secretary of Defense (SECDEF), being responsible for all of the armed forces, the defense agencies, and the Joint Chiefs of Staff has ultimate responsibility for all financial management matters within the Defense Department. He is assisted by the Undersecretary of Defense (Comptroller) (USD(C)) who also serves as the DoD Chief Financial Officer (CFO). The CFO functions are delineated in Chapter 1 of the DoD Financial Management Regulations (FMR). In short, he is the chief financial management policy officer of DoD and chief financial management advisor to the Secretary of Defense. The CFO, DoD is charged with the responsibility of developing and implementing DoD-wide financial management systems and overseeing financial management activities relating to the CFO programs and operations of the DoD.[10] The USD(C) organizational chart is displayed as Figure 18 - Office of the Undersecretary of Defense (Comptroller).

[10] DoD Financial Management Regulations, Chapter 1, paragraphs 0101 and 0102.

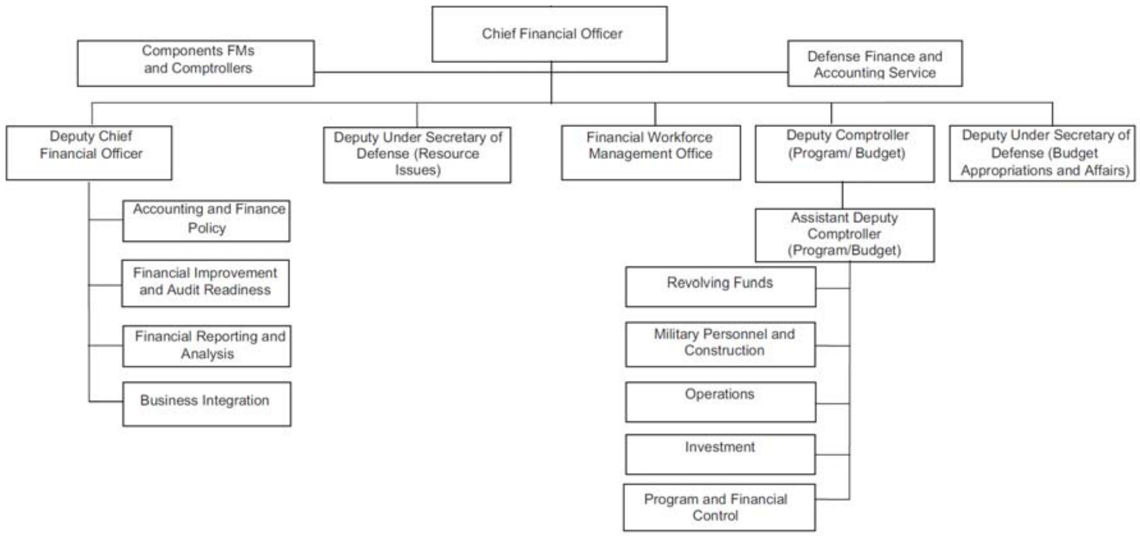

Figure 18 - Office of the Undersecretary of Defense (Comptroller)[11]

Combatant Commanders

The Combatant Commanders (COCOM) are the officers in charge of the unified commands. Unified commands consist of joint forces from two or more services. As of 2007, there are ten Combatant Commanders, six regional and four functional commanders. Regional Combatant Commanders include U.S. Pacific Command (USPACOM), U.S. Southern Command (SOUTHCOM), U.S. Northern Command (USNORTHCOM), U.S. Central Command (CENTCOM), U.S. European Command (EUCOM), and most recently, U.S. Africa Command (AFRICOM).[12] These regional commands are organized on a geographical basis known as Area of Responsibility (AOR). AORs and missions are assigned to the Combatant Commanders through a document called the Unified Command Plan (UCP), which is updated annually if needed.

Functional combatant commands are organized based on a function that they perform. The functional combatant commands include U.S. Transportation Command (USTRANSCOM), U.S. Special Operations Command (USSOCOM), U.S. Strategic Command (USSTRATCOM), and U.S. Joint Forces Command (USJFCOM). In 2010, SECDEF announced[13] his recommendation to close USJFCOM as part of his reinvestment efforts to reduce infrastructure cost and realign funds to warfighter needs. Time will tell if and when JFCOM is disestablished as there are numerous political ramifications that will undoubtedly have to be addressed before the recommendation is approved and implemented.

[11] Available at http://comptroller.defense.gov/fmr/01/01_01.pdf
[12] Department of Defense, Africa Command, http://www.africom.mil/
[13] SECDEF memo Ser OSD 09637-10 on DoD Efficiency Initiatives dtd 16 Aug 2010

The Goldwater-Nichols DoD Reorganization Act of 1986 gave the combatant commanders more opportunities for direct input into the Planning, Programming, and Budgeting (PPBE) process. COCOMs submit Integrated Priority Lists (IPL), during the planning phase, and can also provide issue papers during the programming phase along with the other major commands. The information provided by combatant commanders and their component commanders (such as COMPACFLT) is especially valuable because of their knowledge and command of the operating forces' needs. Goldwater-Nichols provided combatant commanders with full operational control of forces in their AOR and ended years of service rivalry that limited the optimal use of resources. This dramatically changed the relationship between COCOMs, the Service Chiefs, and the Joint Chief of Staff. We'll explore more of those impacts when we look at PPBE, the DoD resource allocation process.

The Combatant Commanders are also heavily engaged in the processes that intersect with PPBE such as Joint Operations, Planning, and Execution System (JOPES), Joint Strategic Planning System (JSPS), and the Defense Acquisition System (DAS) processes. Although their focus is on requirements and not the resourcing of those requirements, COCOMs stay fully engaged throughout the PPBE process as they are a key stakeholder in the outcome of the process.

Secretary of the Navy

The Secretary of the Navy (SECNAV) is responsible for the policies and control of the Department of the Navy, including its organization, administration, operation, and efficiency. The Under Secretary of the Navy, the Deputy Under Secretary of Navy, the Assistant Secretaries of the Navy, and the General Counsel are the Secretary's principal policy advisers and assistants. These civilians are political appointees who have been assigned department-wide responsibilities. They exercise authority that is delegated to them by the Secretary.

Assistant Secretary of the Navy (FM&C)

Each military department has an Assistant Secretary (Financial Management & Comptroller). This individual is responsible for financial management, including budgeting, accounting, disbursing, financing, internal review, and progress and statistical reporting. ASN (FM&C) is the Comptroller for the Department of the Navy.

Two primary divisions within ASN (FM&C) are **FMB** (Office of Budget) and **FMO** (Office of Financial Operations). The Director of Office of Budget (FMB) prepares, justifies, and executes the DoN Budget (both Navy and Marine Corps dollars) for the Secretary of the Navy. The FMB organization oversees the appropriations and is heavily involved in the day to day budgetary functions of financial management. If you had questions or issues concerning a particular appropriation, you would likely engage with FMB. FMB is "dual-hatted," working for the CNO as the Director of the Fiscal Management Division (N82), and is responsible for the Navy's "blue dollar" and "blue in support of green dollar" (Navy in support of Marine Corps) execution. The Programs and Resources (P&R) division of Headquarters Marine Corps handles the Marine Corps "green dollar" execution, reporting to the Commandant of the Marine Corps.

FMO has a longer term perspective. This organization is responsible for overseeing and implementing accounting policy, improvements in financial management, audit readiness, financial reporting and analysis. If you had longer term issues/questions concerning overall financial operations, you would likely engage with FMO.

These two Navy organizations (FMB and FMO) parallel a similar structure in the USD(C) organization note in Figure 18.

Chief of Naval Operations

The Chief of Naval Operations (CNO) is responsible for determining operating force requirements and for fulfilling these requirements. Within the Office of the Chief of Naval Operations, the chain of command runs from the Chief of Naval Operations to commands (both shore establishments and operating forces), and then to field activities. The Office of the Chief of Naval Operations organization is shown below in Figure 19 - Chief of Naval Operations Staff.[14] Many of the DCNOs in the CNO's organization are Appropriations Sponsors and Resource Sponsors. The responsibilities of sponsors will be discussed in Chapter 5.

There have been several changes in the last couple of years but there are two recent changes that are most noteworthy. The N3 (operations) organization merged with the N5 (plans and policy) organization. This reorganization will best support the Navy's Cooperative Strategy for the 21st Century Seapower. The new N3/N5 organization consists of six divisions: N31 – Information, Plans, and Security Division; N39 – Information Operations Division; N51 Strategy and Policy Division; N52 – International Engagement Division; and the Maritime Domain Awareness Office.[15]

The other reorganization of note is the merging of N2 (intelligence) and N6 (communications networks).[16] Once merged, the organization became known as N2/N6 Information Dominance. Resources were realigned accordingly.[17]

[14] From http://www.navy.mil/navydata/organization/org-cno.asp (updated 30 September 2008).
[15] NAVADMIN 081/09
[16] CNO memo Ser N00/100052 of 26 Jun 09.
[17] N09 memo Ser N09/9U103030 of 19 Aug 09

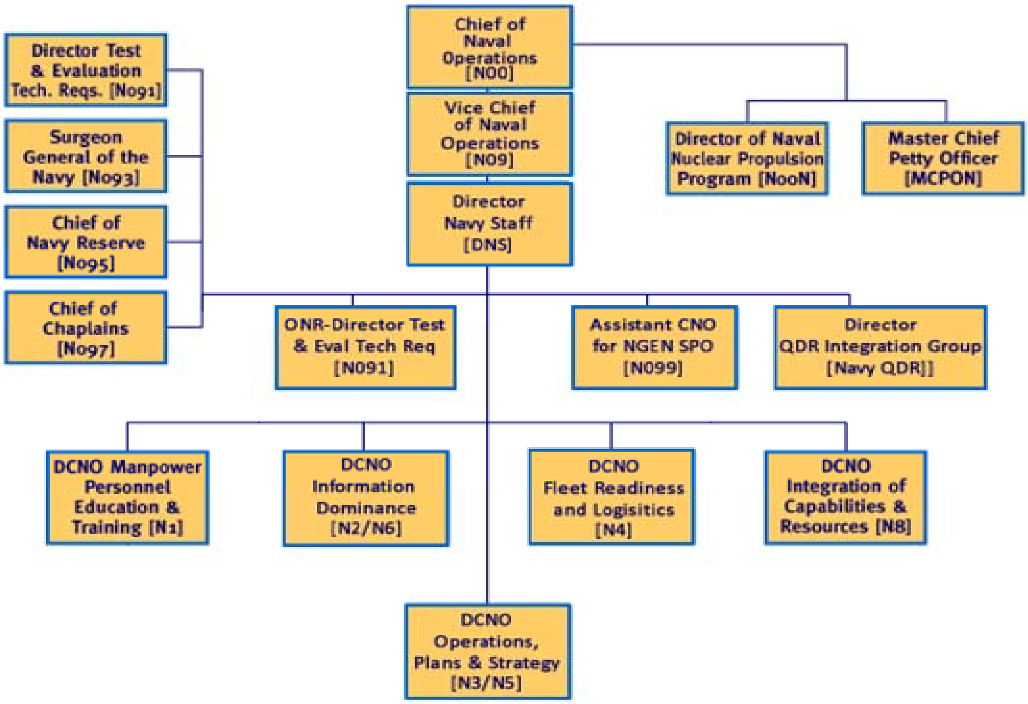

Figure 19 - Chief of Naval Operations Staff

The Office of the Deputy Chief of Naval Operations for Integration of Capabilities and Resources (N8) manages the process of PPBE. Requirements are generated by resource sponsors such as N1 for personnel, N4 for logistics and facilities, N2/N6 for intelligence and communication networks, plus a few others. Within the N8 organization, other resource sponsors reside in the Warfare Integration (N8F) organization. All of these Resource Sponsors develop programs and submit sponsor program proposals (SPP) as part of the PPBE process.

The N80 - Programming, N81 – Capability Analysis and Assessment, and N82 – Fiscal Management staffs manage the PPBE process. These organizations are displayed below in Figure 20 - N8 Organization.[18]

[18] OPNAV Organization Chart distributed by OPNAV Fleet Liaison (CAPT Bump), July 2007

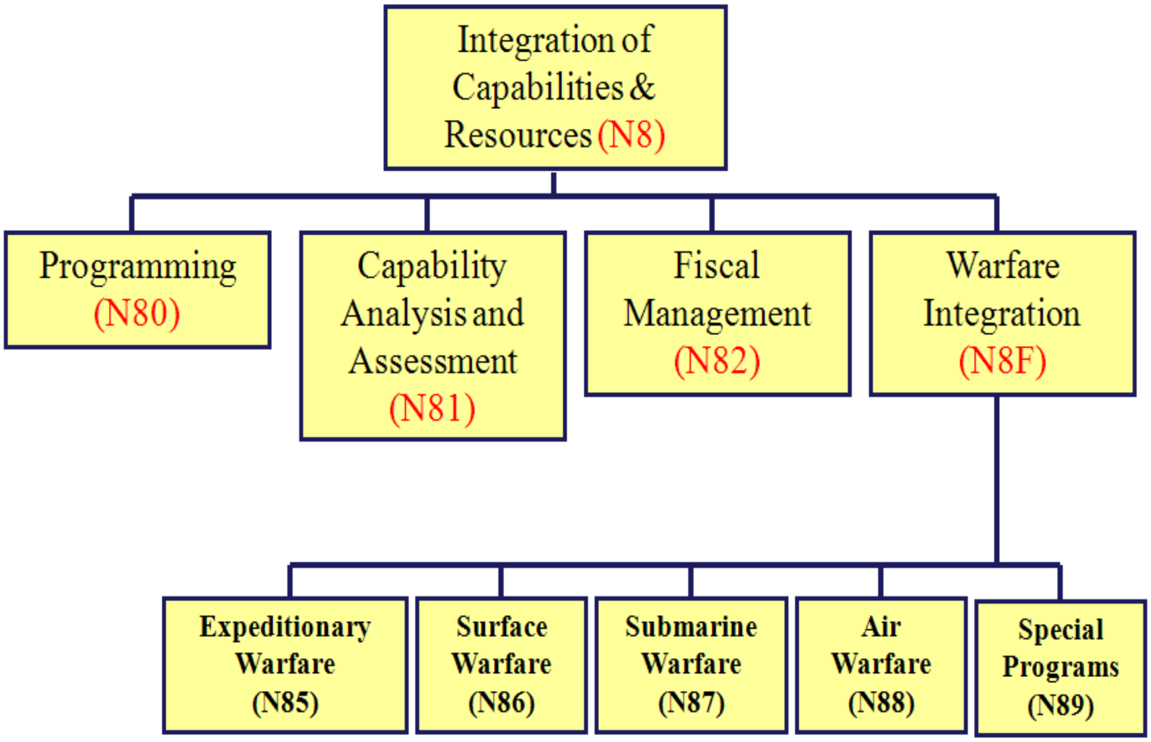

Figure 20 - N8 Organization

N80, Programming Division:[19]

- Is responsible for the programming process for the CNO.
- Provides single consolidated source of Navy programming data for Navy leadership
- Develops the Program Objective Memorandum (POM) Strategy
- Coordinates with FMB to ensure integration of program and budget
- Coordinates development of programs that are to be executed two to seven years in the future
- Defends the Navy POM (Navy and Marine Corps)
- Addresses emergent navy programming requirements from OSD, Joint, Fleet & USMC
- Appraises resource sponsor proposals for new or revised programs
- Works closely with the Resource Sponsors
- Runs the Resources & Requirements Review Board (R3B) process

[19] "Introduction to N8" mission brief, provided by CAPT John Eckhardt, N82, Sep 2010

N81, Capability Analysis and Assessment Division:[20]

- Is responsible for the planning process for the CNO. This includes readiness assessments, sustainment, manpower, personnel and training, infrastructure and strategic planning studies. [21]
- Conducts campaign and mission level analysis to support CNO and Quadrennial Defense Review (QDR) decisions and balances risk across capability areas to deliver the right capabilities within the resources available.
- Performs assessments during the planning phase to support POM development. Includes Front End Assessment and Integrated Capability Plans.
- Work closely with the assessment sponsors and the resource sponsors

N82, Fiscal Management Division:[22]

- Is responsible for the fiscal management of Navy appropriations. This includes:
  - Integrating programming and budgeting activities by coordinating the review of budget estimates submission (BES) within OPNAV to ensure conformance with the POM guidance
  - Controlling and sub-allocating funds which have been allocated
  - Ensuring proper reporting of program status and funds availability
  - Reviewing execution of allocated funds to ensure program objectives are satisfied
- Acts as the appropriation sponsor for the Operations & Maintenance, Navy (O&MN), Other Procurement Navy (OPN), Procurement of Ammunitions Navy & Marine Corps (PANMC), and Navy Defense Sealift Fund (NDSF) appropriations

As discussed earlier, the individual who serves as N82 concurrently serves as FMB in the Secretariat staff.

Budget Submitting Office (BSO):[23]

BSOs are responsible for:

- Preparation of budget estimates within the program, fiscal, and policy guidance provided in the POM, the Budget Guidance Manual, and other guidance as appropriate
- Submission of these estimates in appropriate exhibits
- Ensuring that subordinate offices submit material in time to meet prescribed due dates

[20] Ibid
[21] Navy Budget Guidance Manual, May 2010, Part I-22
[22] "Introduction to N8" mission brief, provided by CAPT John Eckardt, N82, Sep 2010
[23] Navy Budget Guidance Manual, May 2010, Part I-25

- Ensuring submissions are consistent with decisions made during DoN review for the OSD/OMB submission and for the President's Budget submission
- Arranging for appropriation personnel to attend FMB budget review sessions and OSD/OMB budget hearings
- Providing any follow-up information necessary to justify estimates
- Reviewing budget adjustments made by FMB, Officer of the Secretary of Defense (OSD), OMB, and Congressional Committees
- Preparing reclamas or appeals as necessary
- Attending Congressional hearings, reviewing Congressional testimony, preparing answers to Congressional questions or backup materials

Project Manager:[24]

The project manager (PM)

- is responsible for planning, directing, and controlling the development, production, and deployment of a weapon system or equipment. Their acquisition projects generally run the full cycle of requirements development, feasibility studies, designs, advanced and engineering development, prototype fabrication, integration, test and evaluation, production and deployment.
- is designated by CNO or the commanders of systems commands
- provides cost, schedule, and performance data for inclusion in the DoN budget and justifies project estimates at budget review sessions/hearings
- is responsible for ensuring that allocated funds are effectively used and in accordance with authorized purposes

Other organizations
Other organizations certainly play a critical role in DoD financial management. Among those are Defense Finance and Accounting Service (DFAS), with the accounting function; Naval Audit Service, with a management control and auditing function; the systems commands as major budget submitting organizations; the Government Accountability Office with an oversight function, and so on. Most of these organizations are addressed in other portions of this text.

SECNAV Instruction 7000.27A

SECNAVINST 7000.27A was issued on 7 July 2006 "to ensure that the Department of the Navy (DoN) has a financial management organization capable of proper and effective administration of funds complying with applicable laws, regulations, policies, procedures and sound financial practices by providing guidance for establishment, periodic review and approval of comptroller

[24] Navy Budget Guidance Manual, May 2010, Part I-26

organizations in the DON."[25] All comptrollers need to be familiar with this instruction. A few highlights:

(1) Activity Heads will have qualified comptrollers who report *directly* to them.

(2) The comptroller is the principle advisor to activity head for financial matters, but the activity head is accountable… this accountability cannot be delegated.

(3) The activity head is responsible for establishing and maintaining effective internal control systems.

(4) Some comptrollers (primarily System Commands (SYSCOMs)) have a second reporting chain directly to ASN (FM&C).

[25] SECNAVINST 7000.27A, 7 July 2006 available at http://doni.daps.dla.mil/Directives/07000%20Financial%20Management%20Services/07-00%20General%20Financial%20Management%20Services/7000.27A.pdf

Chapter 5: The Planning, Programming, Budgeting and Execution (PPBE) System

Overview

This chapter reviews DoD's Planning, Programming Budgeting & Execution System (PPBE), the DoD resource allocation process. This topic can be very daunting to most students, particularly if they are far removed from the center of the activity in the Pentagon. This chapter has been condensed to help students connect to the broad strategic concepts of PPBE rather than be overwhelmed with the ever-changing myriad of acronyms. Not all acronyms will be eliminated but the focus will be channeled to the comptroller role in PPBE

First it's helpful to discuss the goal of PPBE. From an internal DoD perspective, the goal of PPBE is to provide the combatant commanders (COCOM) with the best mix of resources (people, equipment, capabilities, and support) that enables them to achieve their mission objectives while keeping within fiscal constraints. From an external perspective (outside of DoD), the PPBE process is how DoD attempts to buy their share of the National Security Strategy (NSS) in a politically viable fashion. After all, it's not only about DoD. DoD must compete with other federal agencies for a share of the national treasure.

Now, consider PPBE in the context of how DoD obtains its goods and services. PPBE is only one part of an intricate set of processes that converts the National Security Strategy (NSS) and foreign policy direction of the President into military strategy, war plans, programs, and eventually the DoD budget. Theoretically, at the end of the PPBE process, the DoD budget is the final product, and is eventually incorporated into the President's Budget as budget function code 050. The processes embedded within the PPBE system have been relatively stable during the 1980s and 1990s. From time to time, there have been changes but the overall concepts remains the same as the title: plan, program, budget, and execute. In 2003, Secretary Rumsfeld made process changes but those were recently been modified by Secretary Gates in 2010.

From a conceptual standpoint, it's helpful to think about PPBE in a context that all students can relate to. In reality, PPBE is very similar to many of the activities that students do on a daily basis such as taking this course. Most students have a reason (such as career development, their boss directed it, they are preparing for a certification exam, etc) for taking this course. We call that the "plan" in PPBE. From there, they build a list or take steps or actions (such as fill out paperwork, complete prerequisites, make travel plans, add it to the calendar, etc) toward getting to the course. We call this list the "programs" in PPBE. After that, they secure the funds, potentially through a set of orders in the Defense Travel System (DTS). We call this the "budget" portion of PPBE. And finally, when the student attends the course, they are "executing" and attaining their objective in their plan. Think of other activities that you may do and see if you can identify the planning, programming, budgeting, and execution elements in each scenario. This will help give you a reference point for PPBE on a broad strategic level.

There are various descriptions of the PPBE process currently available in many different venues. The Department of the Navy Program Budget Information System (PBIS) web site[26] contains current Navy PPBE information. In fact, the Navy site is a full two day course. The Navy does a good job of keeping up to date but often times documents, titles, groups, steps, sub-processes get added, deleted, and modified in practice so quickly that it's difficult to keep current. For that reason, this chapter has been significantly scaled down to keep students focused on the broad strategy concepts of PPBE rather than the tidal wave ever-changing details.

One of the best descriptions of the PPBE process was published by the Naval War College[27] (NWC). That text provides a concise history of the PPBE process and does an admirable job of showing the linkage between the Joint Strategic Planning System (JSPS), the Joint Operation Planning & Execution System (JOPES), PPBE and the Defense Acquisition System (DAS). Those are the processes through which the National Military Strategy, war plans, and programs and budgets are developed as well as the means for acquiring the components of the program. This text will not cover that linkage in detail but will briefly describe them so students can see PPBE in relation to other influencing processes. Students are referred to the NWC text for more detail on the supporting processes. This chapter will draw heavily from web sites and the NWC publication, including many of the figures displayed.

The Process

PPBE, as the name suggests, consists of three forward-looking phases: Planning, Programming and Budgeting and one backward-looking phase, Execution. What frustrates those new to the system (and often those who have been in the system for a while!) is that, in a perfect world, these processes would occur sequentially – that is, programming begins when planning ends and budgeting begins when programming ends. In reality, there is a significant amount of gap and overlap.

The overlap results from the complexity and sheer magnitude of the defense budget compounded by the need to meet certain deadlines. Also, while called the PPBE system, the planning "phase" is continuous while the programming and budgeting phases have more distinct annual cycles.

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[26] Department of the Navy web site: https://fmbweb1.nmci.navy.mil/fmb32training/ecenter/PPBE.htm

[27] Sullivan, R.E., ed., Resource Allocation: The Formal Process, U.S. Naval War College, Newport, RI,

Before discussing the various phases in detail, it is useful to look at those organizations that support the process. The Senior Leadership Review Group (SLRG) (formally known as Defense Resources Board (DRB)), provides oversight for all four phases of PPBE and acts as the senior deliberative body responsible for advising the Secretary of Defense on resource issues.[28] In this capacity, the SLRG exercises centralized control of executive policy direction by concentrating on major policy decisions, defining planning goals, and allocating resources to support those objectives including joint.[29] It is chaired by the Deputy Secretary of Defense, other members include the Chairman of the Joint Chiefs of Staff (CJCS), the Director of Planning, Cost Assessment and Program Evaluation (CAPE) (formerly Analysis and Evaluation (PA&E)), several Undersecretaries of Defense (Comptroller, Acquisition & Technology, Policy, Personnel & Readiness), and the service secretaries. Of note is that this group is almost entirely comprised of the civilian leadership of DoD. The service chiefs, and combatant commanders contribute to the SLRG by invitation.

Supporting the SLRG is the 3-Star Group, chaired by the USD (CAPE). The 3-Star Group is responsible for the programming phase. In that role, the 3-Star Group "evaluates military services and defense agency program proposals prior to their presentation to the SLRG."[30]

The Deputy Secretary of Defense Advisory Working Group (DAWG) considers program and budget issues that involve oversight of Quadrennial Defense Review (QDR) implementation and other cross-cutting, high-leverage subjects. The DAWG is co-chaired by the Deputy Secretary of Defense and Vice Chairmen of the Joint Staff and is comprised of the Under Secretaries of Defense, Secretaries of the Military Departments, Service Chiefs, Vice Chiefs of Staff and the Deputy Commander, Special Operations Command (SOCOM).[31]

Keep in mind that these senior leadership groups are very high level, usually three star and above, and civilian equivalent. They provide advice and recommendations at the strategic level. An awareness of their role is good but most students in this course are very unlikely to participate in these groups.

Another key player in the PPBE process is the combatant commander (COCOM). Remember the goal of PPBE is to provide the COCOM with the best mix of resources to enable them to meet their mission objectives. Under the Goldwater-Nichols Department of Defense Reorganization Act of 1986 (PL 99-433), the military chain of command was streamlined and provided a greater role to COCOMs and the Chairman of the Joint Chiefs of Staff (CJCS).[32] The Act provided COCOMs with full operational control over forces in their area of

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[28] Introduction to Program Analysis and Evaluation, available at http://www.pae.osd.mil/
[29] Budget Guidance Manual, May 2010, Part I-27
[30] Introduction to Program Analysis and Evaluation, available at http://www.pae.osd.mil/
[31] Budget Guidance Manual, May 2010, Part I-27
[32] Goldwater-Nichols Act, Wikipedia, available at http://wikipedia.org/wiki/goldwater-nichols_act

responsibility (AOR) to achieve their mission. It also revised the reporting chain of command so that COCOMS reported directly to the Secretary of Defense (SECDEF), leaving the service chiefs no operational control over forces. Service chiefs took on a new role to “organize, train, and equip” (OT&E) forces for use when assigned to a COCOM. In peacetime, forces are assigned to their respective services for OT&E. During war time or contingency operations, forces are assigned to the COCOM for a particular mission. The intent of the Act was to provide unity of command and to reduce or eliminate service rivalry.[33]

You can see that new reporting chain is problematic for COCOMs. Since COCOMs report to directly to SECDEF and they don’t own any assets (other than their small headquarters), they must rely on the service chiefs to provide the forces. Service chiefs are making the resourcing decisions (for their respective service) in the PPBE process. That said, COCOMs play an integral role in influencing the service resource decisions. They influence the PPBE process primarily through their Integrated Priority List (IPL), which is basically a top ten list of capabilities that the COCOM needs resourcing help with in order to meet his/her mission objectives within his AOR. It is not enough to submit the IPL though. COCOMs must stay fully engaged with JCS and the service chiefs throughout the PPBE process to ensure their interests are being addressed within the service.

Planning

The planning phase begins with the National Security Strategy (NSS) issued by the President based upon input by those officials with significant national security responsibility, including the Secretary of Defense, Secretary of State, National Security Advisor, Director of Central Intelligence, Director of Homeland Security, and others. Then the National Defense Strategy (NDS) signed by SECDEF (most recent in 2008) lays out the strategic objectives, gives his own guidelines for implementation and risk management.

The Joint Staff prepares and Chairman of the Joint Chiefs of Staff (CJCS) sign a National Military Strategy (NMS) Document which conveys the Chairman’s message to the Joint Force on the strategic direction the Armed Forces of the United States should follow to support the National Security and Defense Security Strategies. The document describes the ways and means to protect the United States, prevent conflicts and surprise attack, and prevail against adversaries who threaten the homeland, deployed forces, allies, and friends.[34] The NMS is based upon DoD’s role in carrying out the objectives of the NSS. The NMS considers input of the department’s civilian leadership as well as the uniformed leaders on the Joint Chiefs of Staff, in the services and the combatant commands.

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[33] Chain of Command, available at http://www.globalsecurity.org/military/agency/dod/chain.htm
[34] Myers, Richard, B., The National Military Strategy of the United States of America, 2004

These planning documents feed the services' individual PPBE processes, but also serve the joint planning processes. Specifically, the Joint Strategic Planning System (JSPS) relies on the NSS and NMS to develop assessments, strategy and program recommendations from a joint perspective. Further, the Joint Operation Planning and Execution System (JOPES) uses them to develop warfighting plans which drive inputs to PPBE such as the COCOM's Integrated Priority Lists (IPL).

Figure 21 - PPBE in Relation to Strategic Planning and Acquisition Process, adapted from the Naval War College publication, shows the intersection of the PPBE system with the JSPS and JOPES systems. It is modified to account for recent changes in PPBE but still valuable in illustrating various systems of activity that influence PPBE.

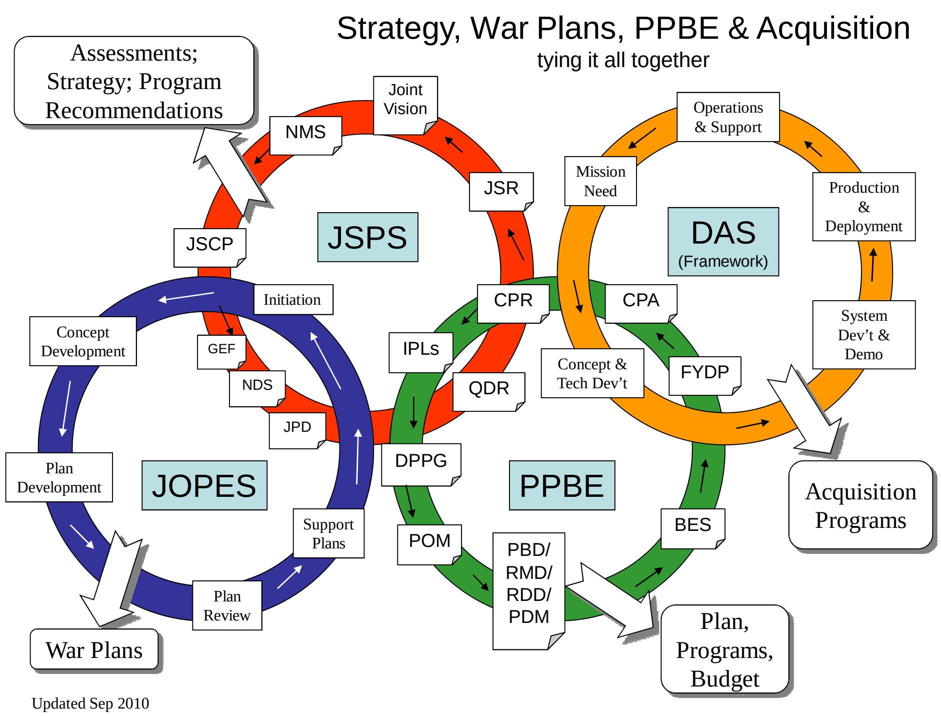

Figure 21 - PPBE in Relation to Strategic Planning and Acquisition Processes

In planning, the national leadership (President and the National Security Council) provides strategic direction to the services and the joint commanders, who initiate their own planning and requirements generation processes. The joint and service-specific processes vary but they must all synch up with the DoD-driven deadlines in order to produce the DoD budget every year.

DoD Planning

In April 2010, DEPSECDEF made changes to the PPBE process at the DoD level. The changes will impact the planning process in future years (beginning with the FY12-16 cycle) but they have an immediate impact on the programming and budgeting processes. We will get to those changes when we address programming and budgeting.

At the DoD level, the outputs from the joint processes take the form of the Integrated Priority Lists (IPL) from the COCOMs, Guidance on Developing the Forces (GDF) and Guidance on Employing the Forces (GEF) (note: these two documents replaced the Strategic Planning Document (SPD) in 2008), and the Joint Planning Document (JPD), all from OSD.

Other documents of a strategic nature are also produced from time to time. Some of these include the Quadrennial Defense Review (QDR) and the service-specific strategic vision such as the Naval Power 21 document for the Navy.

Until recently, this set of strategic planning outputs served as inputs to the Secretary of Defense in his development of the Joint Programming Guidance (JPG). The JPG was the final document in the planning process. It contained fiscally constrained programmatic guidance and performance measures. The JPG drove the development of the Program Objective Memoranda (POM) and Budget Estimate Submission (BES).

DEPSECDEF recently modified that by combining the Guidance for the Development of the Force (GDF) document and the Joint Programming Guidance (JPG) document into a new document called the Defense Planning and Programming Guidance (DPPG). The DPPG now becomes the final planning document in the planning process and the signals the end of the planning phase in PPBE.

To keep students focused, the main point to remember is that the DPPG is now the primary output of the planning phase and it directs the development of the POM and BES at the DoD level. Most financial management students do not operate in the planning phase so it’s difficult to capture and identify with the intricacies of the planning phase. It is, however, important to have an awareness of the inputs, outputs, and activities that occur in the planning phase.

The outputs from the various service processes are beyond the scope of this text. However, we will examine the Navy outputs shortly.

It is worth noting that planning is a continuous process. It's also important to understand that all of these documents aren't necessarily produced every year. They are broad and strategic in nature and don't necessarily require complete revision each year. They are, however, adjusted periodically as required by SECDEF. These documents are out of sync with the neat annual cycles of POM and BES. In fact, years may go by between published revisions of the NSS, NMS, QDR and other strategic documents. This fact partially explains why – up to this point – there has not been a fiscal constraint on the planning process. With the dissemination of the DPPG, the Secretary of Defense forwards to the services and defense agencies topline budgetary numbers from the Office of Management and Budget. These numbers constrain the remainder of the PPBE process. This topline number represents the Administration's intended budget figure for the national defense function in the succeeding year's budget.

To see, graphically, this confluence of documents, refer to Figure 22 - PPBE Significant Documents. This graphic (again, adapted from the Naval War College publication and modified to account for changes in PPBE) shows the complexity of the planning stage and all the actors involved. Note the significance of the DPPG (the number of arrows into it) and the relative simplicity of the programming and budgeting phases. Also of note is the fact that OSD and JCS bare much of the decision making while the services (you!) provide the inputs for the decisions or the end products (POM/BES) based on the decisions already made.

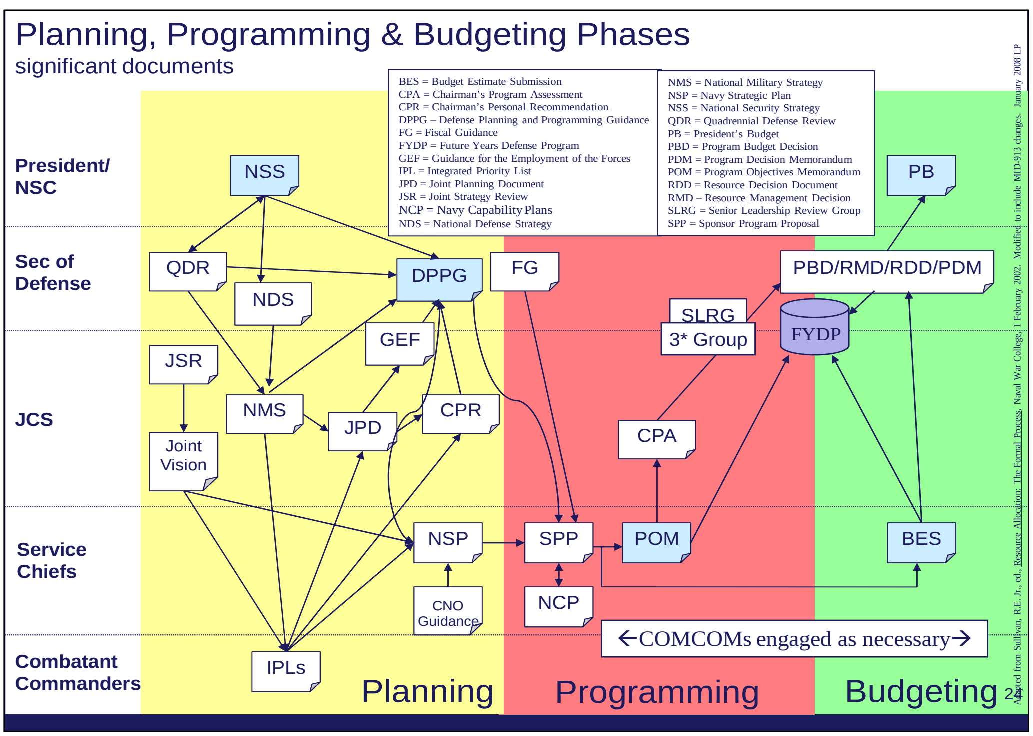

Figure 22 - PPBE Significant Documents

Navy Planning

Now, let's examine the Navy documents relevant to the planning process. There are three primary Navy strategic documents in the planning process. They are the Maritime Strategy/Navy Strategic Plan (NSP), CNO Guidance, and the Navy vision document called Naval Power 21.

- The NSP is produced by the Deputy CNO for Information, Plans, and Strategy (N3/N5). It is a classified document that is produced as the result of the warning order (WARNORD) for each Program Objective Memorandum (POM) cycle. The most recent NSP was published in Sep 2009 as part of POM-12 WARNORD. It provides CNO's strategic guidance form POM development and is the authoritative document for Navy POM priorities. The NSP provides strategic context and Capability/Risk Guidance that provides direction for the Navy's POM and budget submission, highlights areas for analytic study, and indentifies non-material solutions to address critical shortfalls.[35]
- CNO Guidance refers to the CNO's priorities, which have not changed in the last couple of years. Current CNO priorities include building the future force, maintaining warfighting readiness, and developing and supporting Sailors, Navy civilians, and their families.[36]
- Naval Power 21 is the vision for the Navy articulated by the Chief of Naval Operations and forms the centerpiece of the Naval Transformation Roadmap signed by the Secretary of the Navy, Chief of Naval Operations and Commandant of the Marine Corps. The vision is achieved through a strategy called SeaPower 21. The strategy defines the Navy with three fundamental concepts, enabled by one coordinating element, and three supporting initiatives. They are displayed graphically in Figure 23 - SeaPower 21.
    - Sea Strike is the offensive concept. It is a concept for projecting dominant and decisive offensive power from the sea in support of joint objectives. Sea Shield is the defensive concept. It exploits control of the seas and forward-deployed defensive capabilities to defeat area-denial strategies, enabling joint forces to project and sustain power. Sea Basing is the logistics and maneuver concept. It will provide sustainable global projection of American power from the high seas at the operational level of war. ForceNet coordinates the efforts of these three sea concepts. It is the architecture of warriors, weapons, sensors, networks, decision aids and supporting systems integrated into a highly adaptive, human-centric, comprehensive maritime system that operates from seabed to space, from sea to land. The supporting "seas" provide a forum for experimentation (Sea Trial), a process for human resource transformation (Sea Warrior) and a drive for business reformation

[35] N8 memo POM 13 WARNORD Ser N8/10U159093 of 25 Aug 10, Warning Order for Program Objective Memorandum, FY2013-2017 (POM 13)

[36] CNO guidance for 2010, Sep 2009

(Sea Enterprise).[37] Students in this class are mostly like connected to the Sea Enterprise role. It relates to the term “enterprise” and is a concept of operations that strives to provide the right capability at the right cost. One example of an enterprise is the Surface Warfare Enterprise (SWE) which focuses on the business of operating Navy surface ships at optimal cost.

Figure 23 - SeaPower 21

These three documents are key inputs that lead to various analytical products such as the Front End Assessment (FEA), Initial Sponsor Program Proposals (ISPP) and finally, the Integrated Program Assessment (IPA).[38] These three documents are the major outputs of the Navy Planning phase.

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[37] England, Gordon, Vern Clark, and James L. Jones, Naval Transformation Roadmap, 2003.
[38] N8 memo POM 13 WARNORD Ser N8/10U159093 of 25 Aug 10, Warning Order for Program Objective Memorandum, FY2013-2017 (POM 13)

For the purpose of this class, it's not necessary to know all the details that each assessment product provides or who and how it's produced. It is necessary to have an awareness of the plethora of activity that results in the planning phase. The intent is to do a thorough job of review (past, present, and future) and analysis upfront in the PPBE process in order to reduce the amount of re-work and revision during execution. Remember, the focus of PPBE is now on planning and getting it right in the beginning and not on correcting a course that resulted from improper planning.

While the DPPG will be issued late in every calendar year, the second phase of PPBE, the programming phase, is already underway. Programming actually begins in the late months of the preceding calendar year and is based on expected outputs from the planning phase and expected topline figures as represented in the Program of Record (the OSD or PresBud numbers for the budget just being completed.) If this sounds confusing, it is. It is important to note that at any given time, multiple fiscal years of budget and PPBE cycles are "in play." Figure 24 shows the relationship between the current year and what is happening with various fiscal years in the PPBE process. Along the top of the chart you can see the calendar years 2008-2010. Along the left side, you can see the various fiscal years 2009-2011. To use this chart, note the thick dotted vertical line through the month of July 2010. That line denotes a point in time so that we can read the chart.

Starting at the top of the dotted line, you can see we finished executing one-year FY09 funds and are now in the second year of executing FY09 funds. Moving down the dotted line to FY10, you can see we are currently executing FY10 funds. Continue down the dotted line and see that the FY11 funds are currently in the process of enactment with Congress. Next is FY12 funds which are in the POM/BES review process. FY13 funds are currently in the planning phase of PPBE. If you move the dotted line anywhere left or right you can easily determine where the fiscal year funds are.[39] This is an easy way to understand multiple cycles of PPBE going on concurrently and how they overlap and interact with each other.

[39] Keehan, Mark, P., Planning, Programming, Budgeting, and Execution Process, Defense Acquisition University

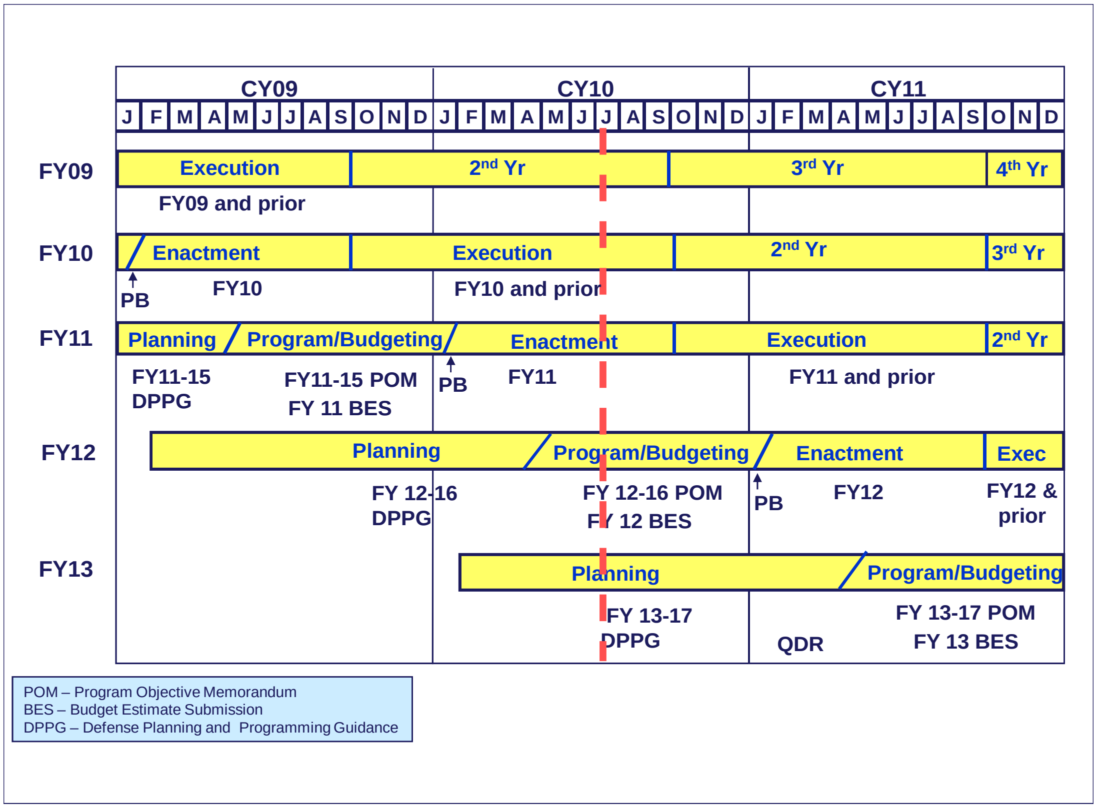

Figure 24 – PPBE Process Overlap

It is important during the PPBE process to stay abreast of what is happening in actual execution of the current year budget – fact-of-life (FOL) changes – and what is simultaneously happening in Congress with next year's budget. The budget being built in the current PPBE cycle must take into consideration the actions of Congress and other events. For the financial manager, it should be becoming clear that the quality of your budgets and the quality of your execution are tightly linked.

Programming

The goal of the programming phase is to define those programs (hardware acquisition, technological development, force structure, logistics posture, manpower requirements, training needs, supporting infrastructure, C4I capability, operating tempo, etc) that will best meet the needs articulated in the planning phase within the fiscal constraints provided. No small feat. If you remember back to the example at the start of this chapter, you may recall that attending this class required you to build a list of action items or objects that you needed in order to achieve your objective (or plan, to attend the course). Programming is where we build that list.

Of benefit to the programmers is that given the magnitude of the department of defense, much of the change from year-to-year is modest and incremental. Recent years have added some challenge for the Navy because of changes in business process related to Naval Power 21. But, for the most part, a ship or airframe can last 20, 30, and 40 or more years; bases have existed for decades; sailors still train and get paid. So the review process focuses more on the marginal changes than a bottom-up review. Of course, new requirements, sudden developments in world events, emerging technology, and shifting political positions will expand or contract the breadth and depth of review, particularly considering the dynamics of the post-9/11 environment. Readers can easily conceive of several examples of each in the past few years.

Overseeing the programming phase is primarily the responsibility of N80 (Programming), who are assisted by N81 (Assessments), N82 (Financial Management). These offices are primarily responsible for the process. They receive a tremendous amount of support from other sponsors who are most concerned with the content and various dimensions of programming. Those sponsors are located in on the OPNAV staff, primarily N2/N6 for hardware and information capabilities, N1 for manpower, N4 for logistics and facility needs and N8F for warfare investments.

During programming, sets of sponsors responsible for advocating certain positions or needs, meet to negotiate that best mix of programs. While close-air-support, nuclear deterrence, and networked healthcare systems all have value, it's not obvious nor universally held which is more important and what the relative value of each should be. So a system has been devised that stimulates the conversation, that demands rigorous analysis, that holds that analysis accountable, and – hopefully – results in the best set of programs, for the right cost, that meet national security needs as defined by the President and will withstand the scrutiny and approval of Congress. The next section will examine those sponsors and their advocacy requirements. While the sponsor names have changed over time and cycle, the list below references what is identified in the Navy Budget Guidance Manual.

Sponsor Definitions and Roles

The **appropriation sponsor** is the senior executive in the DON responsible for supervisory control over a designated appropriation with broad decision-making authority on matters relating to the appropriation. This involves assisting in solving funding deficiencies during budget formulation, testifying before Congress, and recommending the reprogramming of funds within the appropriation during budget execution. These sponsors serve as the lead witnesses before Congress, prepare and review witness statements, respond to Congressional or staff questions, and brief members of the Committees or their staffs. They are responsible for reviewing Committee reports and for preparing consolidated appeals for their appropriations and submitting them to FMB in accordance with FMB guidance and schedules[40]. DON appropriation sponsors are listed in Figure 25 - Appropriation and Resource Sponsors below.

Navy **resource sponsors** are responsible for an identifiable group of resources constituting certain warfare and supporting warfare tasks, such as air, surface, or subsurface warfare. Unlike appropriation sponsors, resource sponsors have a functional or program orientation. The resource sponsor is responsible for interrelated programs or parts of programs in several mission areas. One of the resource sponsor's responsibilities during the programming process is to ensure an effective and balanced program within assigned fiscal controls. Accordingly, during internal budget reviews, the resource sponsor provides assistance when program changes are required to accommodate fact-of-life (FOL) pricing and other funding increases in order to maintain a balanced program.

Probably their most important contribution to PPBE is the submission of the Sponsor Program Proposal (SPP) in the Program Objective Memorandum (POM). The SPP is their product that presents to the leadership in the Navy how to re-allocate resources to meet future capabilities. Resource sponsors are also responsible for providing program guidance to budget submitting offices (BSO) during the development of budget estimates and subsequent reviews of those estimates. They perform key functions in determining program adjustments needed to accommodate FOL pricing increases. Sponsor representatives attend DON budget review sessions, review the Financial Management and Budget (FMB) mark-up, attend OSD budget hearings, review decision documents such as Program Budget Decisions (PBD) and two new decision documents called Resource Management Decisions (RMD) and Resource Decision Documents (RDD). They also participate in reclama reviews. They are responsible for nominating issues to be considered at the leadership meetings and for nominating program offsets as necessary during the course of the OSD/OMB review. These offices are responsible for preparing and reviewing witness statements, answering Congressional questions, briefing members of Committees or their staffs, reviewing Committee reports, and preparing/ submitting to appropriation sponsors proposed appeals in accordance with the schedule established by FMB. Finally and most recently, resource sponsors are assigned capability portfolio management lead responsibilities, engage with DoD Capability Portfolio Managers (CPM) throughout program budget development, and take into consideration CPM guidance and direction. As a quick link and reference point, since CMPs have not been discussed, CPMs are a relatively new concept that was established at the end of President Bush's (43) administration. Capability Portfolio Managers assess capability gaps and overlaps between the services. They are focused on the nine joint capability areas (JCA).

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[40] Budget Guidance Manual, May 2010, Part I-24

Navy resource sponsors are listed in Figure 25 - Appropriation and Resource Sponsors below.[41]

Appropriation/Fund	Appropriation Sponsor	Responsible Office
Military Personnel, Navy (MPN)	N1	CNO(N82)
Military Personnel, Marine Corp (MPMC)	DC/S(P&R)	CMC(P&R)
Reserve Personnel, Navy (RPN)	N095	CNO(N82)
Reserve Personnel, Marine Corps (RPMC)	DC/S(P&R)	CMC(P&R)
Health Accrual, Navy	N1	CNO(N82)
Health Accrual, Marine Corps	DC/S(P&R)	CMC(P&R)
Health Accrual, Navy Reserve	N095	CNO(N82)
Health Accrual, Marine Corps Reserve	DC/S(P&R)	CMC(P&R)
Operation and Maintenance Navy (O&MN)	N82	CNO(N82)
Operation and Maintenance, Marine Corps (O&MMC)	DC/S(P&R)	CMC(P&R)
Operation and Maintenance, Navy Reserve (O&MNR)	N095	CNO(N82)
Operation and Maintenance, MC Reserve (O&MMCR)	DC/S(P&R)	CMC(P&R)
Environmental Restoration, Navy (ERN)	N4	CNO(N82)
Aircraft Procurement, Navy (APN)	N88	CNO(N82)
Weapons Procurement, Navy (WPN)	N86	CNO(N82)
Shipbuilding and Conversion, Navy (SCN)	N86	CNO(N82)
Other Procurement, Navy (OPN)	N82	CNO(N82)
Spares (All Appropriations)	N4	CNO(N82)
Procurement, Marine Corps (PMC)	COMMCSYSCOM	CMC(P&R)
Research, Development, Test & Evaluation, Navy (RDTEN)	N091	CNR(OCNR)
Military Construction, Navy (MCN)	N4	CNO(N82)
Military Construction, Naval Reserve (MCNR)	N4	CNO(N82)
Family Housing Construction, Navy and Marine Corps (FH,N&MC)	N4	CNO(N82)
Family Housing Operations, Navy and Marine Corps	N4	CNO(N82)
Base Realignment and Closure (BRAC)	N4	CNO(N82)
Navy Working Capital Fund (NWCF)	Not applicable	Not applicable
National Defense Sealift Fund (NDSF)	N4	CNO(N82)
Procurement of Ammo, Navy and MC (PANMC)	N82/MCSYSCOM	CNO(N82)/CMC(P&R)
American Recovery and Reinvestment Act (ARRA)		

[41] Budget Guidance Manual, May 2010, Part I-28

Resource Sponsor	Resource Area
Director, Navy T&E and Technology Requirements (N091)	RDT&E
Director, Navy Staff (DNS)	Admin/Physical Security
Director, Total Force (N1)	Personnel Support & Training
Director, Fleet Readiness and Logistics (N4)	Readiness & Logistics (including Sealift)
DCNO for Information Dominance (N2/N6)	Space, C4I, and Information Technology, Intelligence
Oceanographer/Navigator of the Navy (N84)	Oceanography
Director, Expeditionary Warfare (N85)	Expeditionary Forces
Director, Surface Warfare (N86)	Surface Programs
Director, Submarine Warfare (N87)	Submarine/Anti-Submarine Warfare
Director, Air Warfare (N88)	Aviation and Weapons Systems
Director, Special Programs (N89)	Special Programs
Director, Warfare Integration (N8F)	Warfare Integration
Headquarters, Marine Corps (HQMC)	USMC Resources
Secretariat Review Board (SRB)	Secretariat Activities

Figure 25 - Appropriation and Resource Sponsors

Navy resource sponsors are supported by a series of **program sponsors** for managed items. A program sponsor is responsible for determining program objectives, time phasing and support requirements, and for appraising progress, readiness and military worth for a given weapon system, function or task. The program sponsor is the primary Navy or Marine Corps spokesperson on matters related to the requirement for the **particular weapons system or program**. In addition to assisting justifying programs during the budget process, program sponsors assist resource sponsors in resolving funding problems.[42]

Capability Portfolio Managers (CPM) advise the Deputy Secretary of Defense and the Heads of the DoD Components on how to optimize capability investments across the defense enterprise and minimize risk in meeting the Department's capability needs in support of strategy.[43] In the Navy, resource sponsors are assigned capability portfolio management lead responsibilities and engage with DoD CPMs throughout program budget development. The existing joint capability area (JCA) structure serves as the Department's common framework and lexicon for the organization of capability portfolios.[44] CPMs have no decision-making authority. They make recommendations to senior leadership in the Deputy's Advisory Working Group (DAWG). In the Navy, CPM Leads coordinate through the N80 Programming Division and ensure N80 is appraised of any issues being presented to the CPM led Flag/SES decisional body.[45]

[42] Navy Budget Guidance Manual, May 2010, Part I-24
[43] Capability Portfolio Management, DoDD 7045.20, 25 September 2008
[44] Navy Budget Guidance Manual, May 2010, Part I-24
[45] VCNO memo 3000 Ser N09/9U103001, 5 Jan 09, PLANORD for PR FY2011-2015

One can see the inherent tension in this arrangement. A given resource sponsor is responsible for allocating funds across multiple programs all of which use multiple appropriations and must meet capability requirements all within a fiscal constraint. As one of these sponsors adjusts the mix of resources, programs, or funds to best achieve their needs, they drive changes in the plans of other sponsors, requiring them to re-balance. No one acts without affecting the plans of others. This tension and overlap is designed into the system to maximize the likelihood that the most efficient, effective, economical, and worthwhile mix of money, manpower, hardware and capabilities results in the end.

And what is the end result of that tension to find the perfect mix of resources? The Program Objectives Memorandum (POM) is the end product of the programming phase. The POM is a plan for allocating resources (hardware, personnel, and dollars) across a five-year period. It essentially mirrors the Future Years Defense Program (described below). As of 2010, the POM is built annually and includes a five year period.

Budgeting

The POM signifies the end of the programming phase and serves as the primary input to the budgeting phase. The objective of budgeting is to display the approved POM in a manner that complies with OMB directives for federal budgeting, as amended by the DoD and DoN. The DoD Financial Management Regulations (Volume 2) contains extensive guidance on the procedures and formats for budgets for the various appropriations.

Budget formulation is covered in more detail in Chapter 6 of this text, but essentially, the budget takes the first year of each POM and converts the gross numbers into more precise budget justification materials. This is done by Budget Submitting Offices (BSOs) who represent the commands who are most responsible for the day-to-day execution of the program. They know the program best and are the most qualified to submit the budget materials. Figure 26 - Budget Submitting Offices by Appropriation is a list of BSO or Principal Administering Offices (PAO).[46] From time to time this list changes but usually consists of twenty organizations. It is interesting to note that most of these organizations were not directly involved in the earlier phases of PPBE. Much of what occurs in planning and programming is done at the headquarters level, but relies heavily on input from the major commands and systems commands. The BSOs cannot sit on the sidelines during planning and programming and expect to have their activities and programs resourced adequately without their advocacy. BSOs, program managers, program executives, and major commands must

[46] Navy Budget Guidance Manual, May 2010, Part I-29

maintain contact with the program, resource, capability portfolio manager, and appropriation sponsors who have responsibility for their resources. But from the process view, the BSOs are those responsible for executing the final decision, not the ones determining what that decision should be. Because they have the intimate program knowledge and will be held accountable for executing the budget, they are responsible for drafting it.

Department of the Navy Budget Submitting Offices/ Principal Administering Offices are listed below:

Director, Field Support Activity (FSA)
Assistant for Administration, Office of the Under Secretary of the Navy (AAUSN)
Chief of Naval Research (OCNR)
Director, Office of Naval Intelligence (ONI)
Chief, Bureau of Medicine and Surgery (BUMED)
Commander, Naval Air Systems Command (NAVAIR)
Chief, Naval Personnel (CHNAVPERS)
Commander, Naval Supply Systems Command (NAVSUP)
Commander, Naval Sea Systems Command (NAVSEA)
Commander, Naval Facilities Engineering Command (NAVFAC)
Commandant of the Marine Corps (HQMC)
Director, Strategic Systems Programs (SSP)
Commander, Military Sealift Command (MSC)
Commander, Space and Naval Warfare Systems Command (SPAWAR)
Director, Naval Systems Management Activity (NSMA)
Commander, Navy Installations (CNI)
Commander, U.S. Fleet Forces Command (COMUSFLTFORCOM)
Commander, U.S. Pacific Fleet (COMPACFLT)
Commander, Naval Reserve Force (COMNAVRESFOR)
Commander, Special Operations (NASOC)

Figure 26 - Budget Submitting Offices by Appropriation

The budget materials, once compiled, are referred to as the Budget Estimate Submission, or BES. Once the BSO has completed the BES inputs, it is subject to three levels of review, once at the service level, once at the OSD/OMB level, and once by Congress. Each level of review has different requirements and objectives. This is discussed in more detail in Chapter 6, but is summarized here.

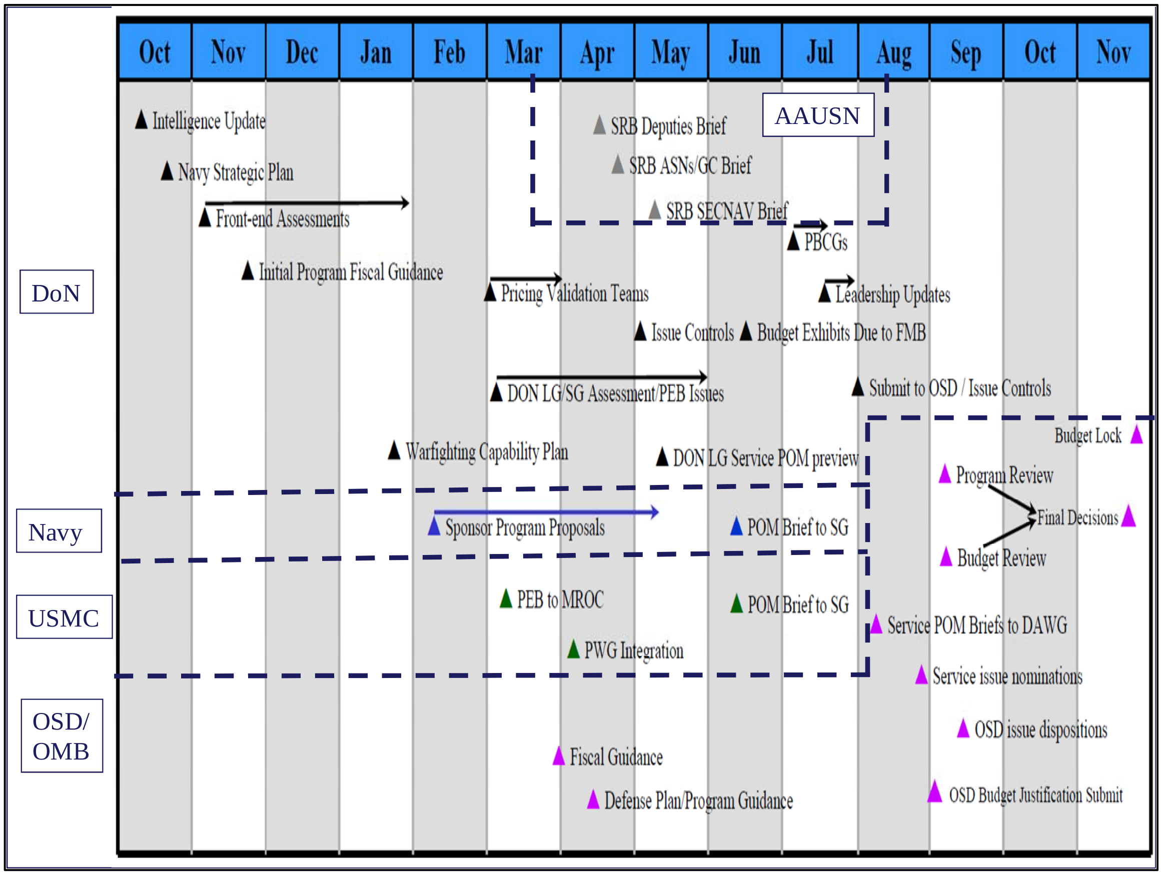
In the summer, the Navy headquarters (Secretariat, OPNAV, and Headquarters, Marine Corps (HQMC)) conducts a review of the POM and BES that focuses on strategic objectives, near-term performance expectations and long-term priorities. At best, the service review is designed to answer the question: does this POM and corresponding budget comply with the guidance received from OSD/OMB and does it represent the optimum use of resources allocated to the Navy? At worst, the Navy review is designed to maximize the probability of passing the OSD/OMB review with minimally disruptive revisions.

The OSD/OMB review takes place in the fall and is the final review before the development of the President's Budget which will be sent to Congress in the following February. The OSD/OMB review will ensure that their guidance (as articulated in the Defense Planning and Programming Guidance (DPPG), OMB circulars, and other guidance) was met and that the services together present a coherent package for the Defense Department. They also balance the DoD requirement against other government agencies and are concerned with congressional acceptance. Recall from Chapter 1 that Congress has the power of the purse and while the budget may be DoD's first recommendation for resourcing national defense, it must still be politically viable and consistent with the current administrations goals. As mentioned in Chapter 1, PPBE is DoD's process for buying their piece of the National Security Strategy. DoD is competing with other federal agencies.

There are two reviews at the component level – both a program review and a budget review. Likewise, there were two reviews at the OSD level. These reviews were combined. It can be said that it takes a well-formulated budget to execute a program, but only a well designed and executable program can get a budget. Given that programs and budgets are inextricably linked, it only makes sense to combine the reviews and streamline the amount of senior management attention. After all, there's no sense in re-visiting the same decisions twice! Budget Submitting Offices (BSO) can expect one set of Navy decisions rather than two. Likewise, at the OSD level, instead of receiving Program Decision Memorandums (PDM) (for program decisions) followed by Program Budget Decisions (PBD), Resource Management Decision (RMD), or Resource Decision Document (RDD) (all for budget decisions) they will be issued nearly simultaneously after a single combined program and budget review. A typical notional program budget calendar is depicted in Figure 27 – Program/Budget Calendar Showing Concurrent Review.[47] In the interest of students reading this text in black and white, it is adapted to reflect who the lead office is for the various activities. The thick dashes separate who the lead office is. Note that ins September the Program Review and Budget Review occur at the same time and lead to decisions made in November.

Although some specifics may vary from year to year, the general battle rhythm remains the same. The basis for the schedule is the requirement that the President must submit the budget to Congress by the first Monday in February. The schedule is designed to comply with that requirement.

[47] Navy Budget Guidance Manual, May 2010, Part I-15



DAWG – Deputy Advisory Group
GC – General Counsel
LG – Large Group
MRB – Marine Review Board
MROC – Marine's Requirements Oversight Counsel
PBCG – Program Budget Coordination Group
PEB – Program Evaluation Board
POM – Program Objective Memorandum
PWG – POM Working Group
SG – Small Group
SRB – Secretariat Review Board

Figure 27 – Program/Budget Calendar Showing Concurrent Review

The Future Years Defense Program (FYDP)

The Future Years Defense Program is the database repository of all approved programs. It summarizes resources (Total Obligational Authority (TOA), personnel, and forces) by fiscal year.

The FYDP was originally conceived as a two-dimensional matrix to "cross-walk" DoD resources from categories of resources to categories of programs. In its first dimension, the FYDP comprises eleven *major defense programs* (six combat force-oriented programs and five support programs). A *program* is an aggregation of *program elements* that reflects a force mission or a support mission of the Department of Defense and contains the resources needed to achieve an objective or plan. A program reflects fiscal year time phasing of mission objectives to be accomplished and the means proposed for their accomplishment. These programs, and the eleven major defense programs, are divided into thousands of individual *program elements* (PEs). PEs are the primary data element in the FYDP database. All programs and resources are mapped to a PE as PEs reflect all approved DoD resources. In recent years, PEs have been mapped to Joint Capability Areas (JCA) as well. As previously mentioned, JCAs represent the capabilities that DoD Capability Portfolio (CP) Managers and Navy CP Leads focus on in the planning phase of PPBE.

In its second dimension, the FYDP has three broad categories of resources: *TOA* (Congressional appropriations), *manpower* (military end strength and civilian full-time-equivalent work years), and *forces* (either items of programmed equipment, or combat units). The FYDP database contains prior year (PY), current year (CY), the budget year (BY) plus an additional 4 years or what is called the "outyears". In addition, the database maintains 3 years of force structure only, meaning metrics not dollars. The database is considered an internal DoD working document (database) and is closely held within DoD. Since the FYDP outyear programs reflect internal planning assumptions, FYDP data beyond the budget years is not released outside the Executive Branch without the permission of the Under Secretary of Defense (Comptroller)). However, in response to a 1987 statutory requirement, DoD provides Congressional oversight committees and the Congressional Budget Office (CBO) a special publication of the FYDP which includes procurement and RDT&E annexes displaying data for the prior, current, budget, and four out years.[48]

The database is updated with every program and budget submission to OSD and with the President's Budget Submission each year.[49] For an additional level of detail, *Resource Identification Codes* (RICs) are used to identify the types of resources assigned to each program element. The three categories of RICs are for manpower (military personnel and civilian personnel), appropriation (or TOA), and forces (hardware or weapon systems, such as missiles, aircraft, etc.).

[48] ACQuipedia, Defense Acquisition University, available at https://acc.dau.mil/CommunityBrowser.aspx?id=362504&view=w
[49] Future Years Defense Program (FYDP) Structure, DoD 7045.7-H, April 2004

Major Force Programs

The FYDP comprises the following eleven major programs under two categories, combat forces and support programs. Definitions of the 11 programs follow. Figure 28 – Major Force Programs shows all eleven programs by category.

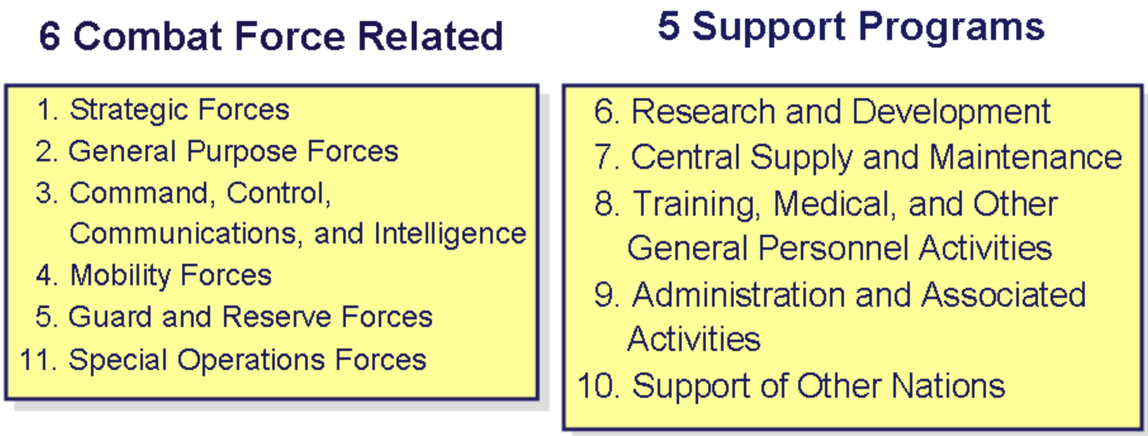


Figure 28 – Major Force Programs

<u>Program 1 Strategic Forces</u>: Strategic forces are those organizations and associated weapon systems whose force missions encompass intercontinental or transoceanic inter-theater responsibilities.

<u>Program 2 General Purpose Forces</u>: General-purpose forces are those organizations and associated weapon systems whose force mission responsibilities are, at a given point in time, limited to one theater of operation.

<u>Program 3 Command, Control, Communication and Intelligence</u>: Comprises intelligence, security, communications and functions, such as mapping, charting, and geodesy activities, weather service, oceanography, special activities, nuclear weapons operations, space boosters, satellite control and aerial targets.

<u>Program 4 Mobility Forces</u>: Comprises airlift, sealift, traffic management, and water terminal activities, both direct-funded and through the Defense Working Capital Fund, including command, logistics, and support units organic to these organizations.

<u>Program 5 Guard and Reserve Forces</u>: The majority of Program 5 consists of Guard and Reserve training units in support of strategic offensive and defensive forces and general-purpose forces.

<u>Program 6 Research and Development</u>: Comprises all research and development programs and activities that have not yet been approved for operational use.

Program 7 Central Supply and Maintenance: Comprises resources related to supply, maintenance, and service activities, funded both directly and through the Defense Working Capital Fund, such as first and second destination transportation, overseas port units, industrial preparedness, commissaries, logistics and maintenance support, depot maintenance and supply management.

Program 8 Training, Medical and Other General Personnel Activities: Comprises resources related to training and education, personnel procurement services, health care, permanent change of station travel, transients, family housing, and other support activities associated with personnel.

Program 9 Administration and Associated Activities: Comprises resources for the administrative support of departmental and major administrative headquarters, field commands, and administration and associated activities not accounted for elsewhere.

Program 10 Support of Other Nations: Comprises resources in support of international activities, including support to the Military Assistance Program (MAP), foreign military sales, the North Atlantic Treaty Organization (NATO) infrastructure, and humanitarian assistance.

Program 11 Special Operations Forces: Comprises force-oriented special operations forces (Active, Guard and Reserve), including the command organizations and support units directly related to these forces.

Program Elements

A *program element* is a primary data element in the FYDP and generally represents aggregations of organizational entities and resources related thereto. Program elements represent descriptions of the various missions of the Department of Defense. They are the building blocks of the programming and budgeting system and may be aggregated and re-aggregated in a variety of ways:

a. To display total resources assigned to a specific program,
b. To display weapon systems and support systems within a program,
c. To select specified resources,
d. In logical groupings for analytical purposes, or
e. To identify selected functional groupings of resources.

The program element concept allows the operating manager to participate in the programming decision process since both the inputs and outputs shall be stated and measured in program element terms. Each program element *may or may not* consist of forces, manpower, and dollars, depending on the definition of the element.[50]

The program element code is seven alphanumeric positions long. The first two positions identify the major force program (01 – 11), and the last position (left justified) represent the component (i.e., N = Navy, A = Army, F = Air Force, M = Marine Corps, DN = Navy Defense Working Capital Fund (DWCF), D8W = Washington Headquarters Services, etc.) For example, 020122N would be a program element number under major force program 2 (02) and is a Navy (N) program. The numbers in between are assigned by the component and have special uses for certain major force programs. See the FYDP handbook for complete codes and details.

Figure 29 – Future Years Defense Program (FYDP) depicts the links between the last three topics discussed. Embedded in the intersections between major force programs, components and appropriations are the thousands of PEs described above.

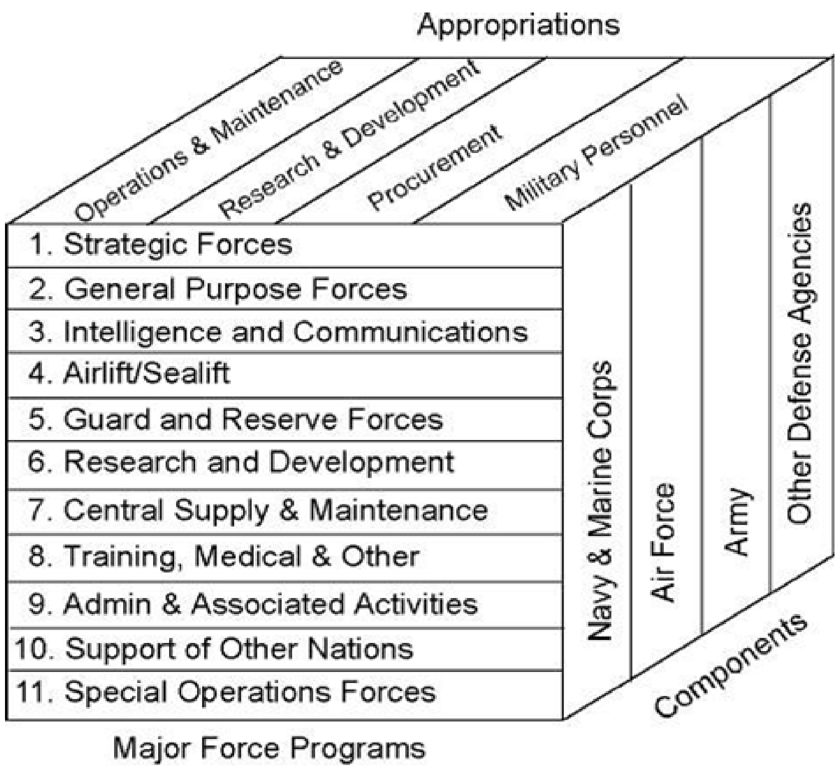


Figure 29 – Future Years Defense Program (FYDP)

50 Future Years Defense Program (FYDP) Structure Handbook, DoD 7045.7-H, April 2004

Summary

At this point, students should be able to make the following connections

- Link between capabilities and those who concerns themselves with capabilities (OSD CPMs, DoN CP Leads, and N81 Planners) in the planning phase of PPBE.
    - How capabilities are organized (JCA structure) and linked to resources (PE).
- How programs are organized (11 major force programs) and linked to resources (PE), and who leads (OSD CAPE and Navy N80) the programming phase of PPBE.
    - How programs reflect fiscal year time phasing (4 outyears) of mission objectives to be accomplished and the means (ships, aircraft, combat units, etc) proposed for their accomplishment.
    - Programs add specificity or granularity to the FYDP whereas capabilities are about outcomes or effects.
    - Programs are fiscally constrained where capability planning is fiscally informed and not necessarily fiscally constrained.
- How budgets are presented (PY, CY, BY) and linked to resources (PE), and who leads (OSD(C) and FMB dual hated as N82) the budgeting phase of PPBE.
    - Budgets bring more precision to fiscal resources, focus on executability, balance, and links to guidance.
    - Budgets translate the POM programs into appropriation language for Congress.
- The common element in all three phases is the PE which is housed in the FYDP database. The database is sorted by appropriation (for Congress's benefit), by major force program (for DoD's benefit) and by service (for each service's benefit).
    - The database is the equivalent of a planning document closely held by DoD. It is updated to coincide with the submission of the program and budget submissions to OSD and with the President's Budget submission. All approved resources and programs are contained in the FYDP.
    - Since programs span across more than one year, it only makes sense that CAPE is the gatekeeper of the data base.

Chapter 6: Budget Formulation & Review

What is a Budget?

"The Constitutional purpose of a budget is to make government responsive to public opinion and responsible for its acts." - President Taft[51]

"The defense budget is an instrument of foreign policy…"[52] - Professors McCaffery & Jones, Naval Postgraduate School

"A budget is defined as a document which expresses in financial terms the plan for accomplishing an organization's objectives for a specified period of time. It is an instrument of planning, performance measurement, decision-making, and management control, as well as a statement of priorities. Such a definition is descriptive of the Department of the Navy (DON) budget."[53] - Chapter1, Part 1 of the Navy Budget Guidance Manual.

Professor Allen Schick of the University of Maryland refers to budgeting as *a process of allocation, redistribution, choice among the many claims on public resources, rationing, role and priority setting – all of which lead to conflict. But it also has distinct stages, processes, procedures, routines and repetitive tasks that establish expectations and deadlines, limit the debate, and ensure that issues are resolved. In budgeting, there is conflict and resolution.*[54]

Aaron Wildavsky – the preeminent name among scholars of public budgeting – refers to the budget as:

- *a) a prediction;*
- *b) the "link between financial resources and human behavior in order to accomplish policy objectives;"*
- *c) "a series of goals with price tags attached;"*
- *d) a contract (between the executive and legislature);*
- *e) "a web of social as well as legal relationships;"*
- *f) "a part of the process of cooperative action in which commitments to contribute resources are joined to commitments as to their use";*
- *g) "the irrigation system that provides the water without which an agency and its products would parch and wither"*
- *h) "a representation in monetary terms of governmental activity"*

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[51] Quoted in Jesse Burkhead, Government Budgeting, New York: Wiley, 1955.
[52] McCaffery, Jerry and L. R. Jones, Budgeting and Financial Management for National Defense, Greenwich: IAP Publishers, 2004, p 3.
[53] Navy Budget Guidance Manual, May 2010, Part I-2.
[54] Schick, Allen, The Federal Budget: Politics, Policy, and Process, Washington: Brookings, 2000, pp 1-5.

i) *a record of the outcomes of the struggle over political preferences; and*
j) *"attempts to allocate scarce financial resources through political processes in order to realize disparate visions of the good life."* [55]

As noted in the first chapter, the requirement for developing a federal budget rests with the Executive Branch; the Legislative Branch authorizes programs to exist and appropriates the funds with which they will operate. Development of an effective budget depends on all personnel in the activity. Whether a zero-based approach is taken or an historical incremental approach within control numbers is used, all personnel must take an active role in budget development and execution. In addition to identifying all requirements that can be funded, it is important to identify those *valid* requirements that cannot be funded. As a plan, the budget must be flexible and be able to accommodate changes. This is easier said than done!

Budget Formulation Overview

This chapter focuses on budget formulation from the perspective of the Budget Submitting Office (BSO); however, all activities have budgetary requirements and provide input to the process. Budget formulation involves translating the approved programs in the first year of the POM into detailed budget exhibits by appropriation. It begins with the budget call and is guided by OMB, OSD, the service comptroller, the DoD FMR, and service Budget Guidance Manual and various memoranda.

The budget process consists of four phases.

1. The **first** is the submission of budget estimates from BSOs to the Office of Budgeting (FMB). These estimates are submitted for review and final approval by the Secretary of the Navy.
2. The **second** phase is the submission of budget estimates by the DoN to the Office of the Secretary of Defense (OSD) and the Office of Management and Budget (OMB) for review and final approval by the Secretary of Defense and the President.
3. The **third** phase is the submission of budget estimates by the President to the Congress for its review and approval.
4. The **final** phase is the enactment of appropriations by the Congress and execution of the appropriations by the DoN.

A DoN budget is developed for the first three phases, but the organizational responsibilities and control vary with each phase. Embodied in every phase, however, is the Department's basic policy that the offices that are responsible for executing budgets participate in developing budget estimates, subject to the guidance and decisions of higher authority.[56]

[55] Wildavsky, Aaron and Naomi Caiden, The New Politics of the Budgetary Process, 4^{th} ed., New York: Addison-Wesley, 2001, pages 1-6.
[56] Budget Guidance Manual, May 2010, Part I-2

The DoN budget serves as a control mechanism to ensure that financial resources are applied to the activities that were approved by the decisions-makers in the process. The DoN's policy of having BSOs participate in each phase is intended to produce better decisions and to provide those offices with a better understanding of the decisions so that they can better execute the budget.

Organizations in the Budgeting Process

In the chapter 3, we identified several key players in the PPBE process. There are a few more worth mentioning here as they play a key role in budget formation.

Responsible Office (RO). The CNO (N82) is the Responsible Office for the military personnel, operations and maintenance, procurement and construction appropriations for the Navy. The RO carries out fiduciary responsibilities for appropriation sponsors. A Responsible Office is responsible for all programs funded by a particular appropriation; ensuring Congressional intent is met at the Budget Activity (BA) level and below. (We'll address budget activity codes later in this book but for now, think of the BA as the first subdivision of an appropriation.)

The Commandant of the Marine Corps (CMC) is the Responsible Office for all Marine Corps appropriations (Military Personnel [active and reserve], Procurement, Operations and Maintenance [active and reserve]).

Systems Commands (SYSCOMs) and Program Managers (PM). Although we already mentioned Program Managers (PM) in chapter 3, it's worth repeating and putting them in another context to show their relationship to certain organizations. SYSCOMs, such as the Naval Sea Systems Command, and Program Managers who usually work at SYSCOMS, will budget for investment items (procurement and construction appropriations) as well as their own operating and support costs. Their submission eventually goes to N82, who is the *Responsible Office* for all Navy appropriations *except* for Research, Development, Testing and Evaluation (RDT&E). RDT&E is submitted to FMB via the Chief of Naval Research (CNR). Depending on the size and complexity of the program, some PMs may submit budget estimates for multiple appropriations and multiple BAs within appropriations. The project manager provides cost, schedule, and performance data for inclusion in the DON budget and justifies project estimates at budget review sessions/hearings. The project manager is also responsible for ensuring that allocated funds are effectively used and in accordance with authorized purposes.[57]

N82 supervises the development of the Navy's budget for most appropriations, and receives input from the Budget Submitting Offices (BSOs), as identified in

[57] Navy Budget Guidance Manual, May 2010, Part I-26

the previous chapter but, as a reminder, some examples include FFC, PACFLT, NAVAIR, NAVSEA, and HQMC. One can now make a connection between SYSCOMs and BSOs.

Principal Administering Offices (PAO). PAOs are DON components responsible for executing funds allocated by OASN (FM&C) or the Chief of Naval Operations. A PAO may also be a Budget Submitting Office (BSO). The term BSO is used when referring to a DON component responsible for preparation, compilation, and submission of budget materials whereas as PAO refers to execution of funds.

Administering Offices. Administering Offices are offices that are responsible for fiscal management of an entire appropriation/fund or of a specifically assigned portion of an appropriation. Administering Offices fall under the Responsible Office. They will compile and review budget estimates, as appropriate, before sending them to N82. An example of an administering office would be the Bureau of Personnel (BUPERS) for Military Personnel appropriation. Systems Commands and Program Managers are administering offices for appropriations such as Aircraft Procurement (NAVAIR), Shipbuilding and Conversion (NAVSEA), Weapons Procurement (NAVSEA) and Military Construction (NAVFAC).

If it's not clear by now, a command could also serve multiple roles such as BSO, PAO and SYSCOM. NAVAIR and NAVSEA are good examples of that. Taking it a step further and recalling the roles in the previous chapter, it's often helpful to connect the terms through an example. Recall the other roles (RO, appropriation sponsor and resource sponsor) are executed by organizations at the higher headquarters. An example would include N82 as the RO for the Aircraft Procurement (APN) appropriation while N88 is the appropriation sponsor for APN and resource sponsor for Air Warfare. That all occurs at DoN Headquarters. Naval Air Systems Command (NAVAIR) is the BSO and PAO supporting and submitting budget input to the higher headquarters. For a more detailed look at the players, students are referred to the Navy Budget Guidance Manual, Chapter 2, Part I-28.

Budget Considerations and Budget Terminology

Again, budgeting is the costing and planning of the POM. Using a simplified analogy, if the POM is for a "barbeque dinner for 6 people", the budget would contain items such as the cost of the food and consumables supplies, the pay for the cook, electricity allocated to the kitchen, charcoal for the grill, perhaps annual depreciation for the cost of the grill, etc. The budget justification materials contain two significant parts: the narrative description and the financial information.

Narrative. It is imperative that the analyst preparing the budget exhibits understands the nature of the program or activity that they are describing. It is not enough to simply copy and paste inputs from the operator/customer/end-user of the program. The analyst must understand the military significance of the program and be able to articulate the program in terms relevant to senior leadership. The narrative should also be written in terms that comply with the budget call, POM guidance, and other strategic documents. This is the final output of the PPBE process and should reflect all the preceding work.

A well-written narrative will not only describe what the funds are buying (outputs), but why they are being purchased (the outcomes affected). The first part is relatively easy: numbers of people, barrels of fuel, spare parts, service contracts, numbers of units of an acquisition item, etc. The latter part should be written with an eye on the Strategic and Programming Guidance. Those documents guided the POM process which chose to invest a certain amount in a particular program. The rationale why a program is being funded should be articulated clearly and succinctly. Time and space are limited so the analyst must choose words carefully for budget exhibits. Just what part of the Programming Guidance is this program attempting to satisfy? Some of the wording may be found may be found in program critical documents or even appropriation language. For example, one would not use terms like research or testing in a narrative supporting an Operations and Maintenance (O&M) request.

The narrative should also reflect the decision segment used during the decision process. The decision segment describes the process by which the numbers were derived. That is, a program that was selected as part of a future **mission capability** study should address the capability it provides to the operating forces. A program funded based on a **performance model** should address the inputs and outputs of the model. A **level of effort** program should define the level of effort and benefit provided.

<u>Financial</u>. It is equally imperative that the analyst understands the nature of the costs to deliver the program, capability, or activity. Costs take several forms, can vary over time, and can change character when combined or interacting with other elements. It's important to know and understand how costs behave. **Fixed** costs (and some indirect costs) are those that do not vary with the amount of activity or volume or work. Some examples include administrative salaries and fire protection costs at an installation. Some may even argue that civilian labor is a fixed cost at most activities, as it remains relatively constant (at least across the budget year). **Variable** costs (or direct costs) vary directly and proportionately with the amount of activity or output. Variable costs are fixed per unit of output but will vary as the output or activity changes. Some examples include utilities involved in manufacturing or overhaul, transportation costs, packaging and fuel for material handling equipment. **Controllable** costs are those that can be significantly influenced by actions at the activity. In the short-term, most costs are non-controllable. In the long-term, they are controllable. For example, a large portion of the budget could be for civilian labor, a portion is for utilities, contracts, etc. Little of the budget is controllable and leaves little flexibility;

therefore, the financial manager must look at some of the controllable costs for reductions.

Budget analysts must be sure to budget for pay raises and increases to fringe benefits. Inflation factors, economies of scale, and learning curve must also be considered in building the budget. These factors are usually outlined in the budget call guidance.

Funding Policy

Full Funding. Full funding means that the entire cost to procure an item is budgeted and obligated at the time it is ordered. Full funding is required when Congress directs, if using a procurement appropriation, the effort is non-severable, or a distinct finished product will be produced. Full funding requires that each year's procurement and Military Construction (MILCON) appropriation requests include the funds estimated to be required to cover the *total cost to be incurred in completing delivery of a given quantity of usable end items* such as aircraft, missiles, ships, vehicles, ammunition, or facilities. Deliveries must be completed within a one-year period after the first delivery on a particular contract is made (excluding MILCON).

Full Funding example:

Procure 50 Production missiles*	FY08	FY09	FY10	FY11	Total
Incur Costs					
Prime Contractor	1.0	3.0	3.5	.5	
Guidance Section	.5	2.0	2.3	.6	
Govt. Testing	-	-	.5	.2	
Total Costs	1.5	5.0	6.3	1.3	14.1
FY of Funding	**14.1**				

*Vehicles to be delivered December 10 - November 11

Two exceptions to full funding exist: Advance Procurement and Multiyear Procurement.

Advance Procurement (AP). This is an exception to DoD's full funding policy. Advance procurement involves budgeting for long lead-time items in advance of the fiscal year in which the end-item is budgeted (*normally for the major procurement appropriations and in limited circumstances*). Advance procurement will ordinarily be budgeted only one year in advance of the end-item funding year and should be for only a small percentage of the overall requirements. The funds are added to the budget authority for the prior fiscal year and deducted from the budget authority of the fiscal year for which it is identified. Economic Order Quantities (EOQ – items that exceed the current year requirements but are more economical to procure as EOQ items) should be included in advance procurement budget requests and should satisfy no more than five program years of requirements. AP is used in order to reduce the overall procurement lead-time of the major end item. In the example below, a submarine is budgeted in FY10 for a cost of $5.0 billion with $400 million in advance procurement.

Advance Procurement Funding example:

Build a submarine in FY10	FY09	FY10
FY10 Adv Proc	0.4	
FY10 SCN		5.0
Less FY10 Adv Proc	-	(0.4)
Total Received	**0.4**	**4.6**

Multi-year Procurement. Multi-year procurement (MYP) is a contractual commitment for support of outyear end-items and is an exception to full funding, requiring Congressional approval. MYP is to be identified in the POM and budgeted accordingly. A contract may cover more than one year (usually up to five years), the funds are budgeted and the contract is financed in *annual increments* that fully fund only the annual requirements. MYP protects the contractor from loss due to canceling subsequent increments by allowing reimbursement of unrecovered, nonrecurring costs through a cancellation charge. MYP is normally used for major acquisition programs when they reach stable manufacturing processes and the production risk is minimized.

Incremental Funding. This is the alternative to full funding. Incremental funding means that an effort is financed in periodic (normally annual) portions or phases. Incremental funding is required when the effort is severable, such as recurring support, or for most research and development efforts.

Incremental Funding example:

Build and Test a prototype missile	FY08	FY09	FY10	FY11	Total
Incur Costs					
Design	2.0	3.0	.5	-	
Build	-	-	5.0	-	
Test	-	.5	.1	.2	
Total Costs	2.0	3.5	5.6	.2	11.3
FYs of Funding	**2.0**	**3.5**	**5.6**	**.2**	**11.3**

Other Considerations

Reimbursables. Reimbursables are funds received by one activity (performing activity) in return for services or items provided to another activity (customer.) You must consider the amount of reimbursable expenses that you will incur as a customer, or perhaps the amount of reimbursable funds you may receive as a provider. Because reimbursable amounts are included as part of your Total Obligation Authority (TOA), you must consider this funding during your budget formulation process, to the extent that you know it exists. Reimbursables are discussed in detail in chapter 8.

Award Fees and Incentive Fees. Contracts will sometimes have award or incentive fee clauses to motivate the contractor to perform or to meet predetermined criteria associated with the tasks of the contract. These fees are paid pursuant to the specific terms of the contract, generally when earned by the contractor, sometimes after a government board has convened to review performance. Although every effort should be made to determine the amount of the fee prior to funds expiring, in some cases this is not possible due to the nature of the work. The fees should not be recorded as an obligation until earned. Fiscal policy requires fees to be paid from program year funds associated with the work product and are not considered upward obligations.[58] In other words, if FY09 resources are used for the work effort, then the fee must be paid from FY09 funds, no matter when the fee is earned, even if earned and recognized in FY10. This is a change from previous years and it recognizes there will likely require some commands to have unobligated balances in expiring accounts. This anomaly should be communicated up the chain of command.

Full-time Equivalent (FTE) Ceilings. Per the Federal Work Force Restructuring Act of 1994, FTE ceilings are issued to each agency on the number of full-time equivalent work years that may be executed from FY1994 through FY1999. Although the act expired on 30 September 1999, OMB still imposes a FTE ceiling. A FTE is normally 2,080 hours (40 hours per week times 52 weeks). FTE ceilings are issued to each major command. They have the flexibility to realign the ceiling among appropriations or working capital fund (WCF) activity groups while remaining within the total ceiling. Therefore, activities must monitor their FTE ceilings and execution, along with their dollars for payroll and benefits.

The Budget Call

Because the President must submit an annual budget to the Congress, the budget call begins at OMB with the annual issuance of OMB Circular A-11. OMB Circular A-11 provides guidance to all executive departments on how to prepare its budgets, and is issued in the July timeframe. The budget call flows down the chain of command similar to the flow of funds description in Chapter 2.

Budget calls delineate the submission format and schedules, as well as control numbers, inflationary factors, FTE manpower ceilings, restrictions such as ceilings, fences, floors and special interest items, required exhibits and other administrative guidance. Control numbers are issued by appropriation to each BSO, and are derived from the PPBE changes since the prior President's Budget.

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[58] OSN (FM&C) memo, Guidance for Recording Award and Incentive Fees and Other Undefinitized Contractual Costs, 22 Aug 2008, available on PBIS https://fmbweb1.nmci.navy.mil/policy/AwardFee22Aug2008.pdf

USD(C) and ASN (FM&C) issue budget calls as well, often in advance of the issuance of OMB A-11. ASN (FM&C), via FMB, issues its budget call in the May timeframe. Since three versions of the budget are prepared each year, one can expect a series of budget calls will be issued. Budget exhibits normally will contain prior year (PY) information from the last completed fiscal year, current year (CY) information and the budget year (BY1).

We know from the PPBE chapter that the decisions regarding what is in the budget is primarily a top-down process, but the actual formulation of the budget is more decentralized and spread across many activities. ASN (FM&C) issues the "Budget Guidance" (BG) series of memoranda (e.g., BG09-1, BG09-1A, BG09-2, etc., for the FY2009 budget estimate submission). In addition, the Navy's Budget Guidance Manual and DoD Financial Management Regulation (FMR) Volume 2 provide additional budget estimate submission guidance.

The level and size of the activity may determine how the budget is formulated. Some activities may choose to do a decentralized approach and solicit inputs from all departments and divisions, while others may elect for the comptroller to prepare the budget in its entirety. Inputs could range from a spreadsheet, to an email, to DoN budget exhibits, depending on the level and size of the activity. It would be impossible to cover all the possibilities in this text.

Budget Exhibits

The specific budget exhibits that a BSO must prepare depend on many factors. It is primarily appropriation-driven with a few required exhibits for all programs within an appropriation. Other exhibits are completed on an ad hoc basis. All the common budget exhibits, their purpose, who completes them, and the source for detailed guidance can be found in the Navy's Budget Guidance Manual. Part 2 lists the exhibits required for the Navy budget, Part 3 the OSD/OMB budget, and Part 4 the President's Budget. Some examples are shown below in Figure 30 - Budget Exhibit Examples. This guidance is further amplified by the Budget Call and the annual budget guidance memos. Analysts need to ensure they are reading all applicable guidance to ensure their limited time during budget development is not wasted.

Exhibit No.	Title	Approp.	Source	Reference
OP-5	Instructions for Summary and Justification of Changes in Resources	All	BSO	FMR 3-21/32; 8-4; 6-22
Description: Provides increases and decreases (program and pricing) between and within fiscal years (for fiscal years PY-BY1). *Note special requirements for JCS exercises, base support, transportation, FSRM, and training.				
OP-32	Summary of Price and Program Change	All	BOCS	FMR 3-131
Description: This exhibit provides a summary of price and program changes due to Foreign Currency Fluctuations, Price Growth, and Program Growth.				
OP-40	Ship Fuel and Operating Tempo Data	OMN/ OMNR	FFC/ PACFLT/N43	FMR 3-157
Description: The purpose of this exhibit is to represent the OMN/OMNR Ship Fuel and Operating Tempo Data for the Deployed and Non-Deployed Fleet. The template provided in PBIS must be used.				
P-3a	Individual Modification	All but SCN	BSO	FMR 4-19/22
Description: This exhibit is requires a description of what additional capability is added to a system by this modification, and why the modification is necessary (i.e., to increase reliability, maintainability, or mission capability).				
P-5	Cost Analysis	All	BSO	FMR 4-23/30
Description: The purpose of this exhibit is to provide detailed cost information in support of Exhibit P-1 line items consistent with the appropriate work breakdown structure (WBS) elements for the programs. It is essential that this exhibit be complete and accurate, as it is the most important exhibit in the backup book.				
P-40	Budget Item Justification	All	BSO	FMR 4-73/75
Description: The purpose of this exhibit is to provide overall narrative justification and total procurement costs for each P-1 line item. Include all advance procurement, initial spares and repair parts for acquisition category 1 programs.				

Figure 30 - Budget Exhibit Examples[59]

[59] Navy Budget Guidance Manual, Part 2, May 2010

Budget Review

Chapter 5 briefly discussed the role of budget review in the context of PPBE. This section will look at the content of the budget review and strategies for budgeting effectively so that the review goes smoothly with minimal disruption. There are three levels of budget review: the component or service review, the combined OSD/OMB review, and the Congressional review. Of course, this assumes there is some sort of internal command review before the service review! These vary from command to command, depending many factors like size, complexity, leadership, etc. The review process begins in the summer at the component level and ends the following summer when Congress develops the authorization and appropriation bills.

Component Review of the Budget Estimate Submission

Of course, the review process will begin at the activity level with the comptroller and commanding officer reviewing the budget estimate submission. The budget will be reviewed for balance across all resource areas, and key resource allocation decisions will be made. Upon completion of the command review, it will be forwarded to the applicable Administering Office (AO) or Budget Submitting Office (BSO) where it will be consolidated with other estimates, then forwarded to FMB. Of note is that the program and budget reviews are combined at the Navy level now. Recall from the PPBE discussion, this combined review occurred at the OSD level, but not at the Navy level. Nevertheless, the purpose of this chapter is budget formulation – whether the budget is reviewed with the program or subsequently, the principles of good budget writing are the same. What differs is perhaps the degree of importance. Reviewing the program that is funded by the budget simultaneously requires a closer coordination between the program manager and the budget staff to ensure the story is fully articulated.

Major commands, or Budget Submitting Offices (BSOs), submit their budgets to FMB based on the approved POM and the guidance contained in the Budget Guidance (BG) series of memoranda issued by FMB. Normally, a set of questions accompanies the budget call. These questions may be routinely asked year after year or may be unique to the subject budget years. They may be applicable to all programs in an appropriation or budget activity or they may be targeted at a specific program. These questions are not part of the formal budget submission that will eventually go to OSD, but rather forms – along with the budget exhibits – the basis for review by the FMB analyst.

During the service review itself, FMB will often ask more routine written questions and may conduct informal DoN hearings to ensure that the budget estimates:

- Are in agreement with the POM, SECDEF and other guidance, and available decision documents;
- Contain current and valid costs and pricing;
- Are well justified and consistent;
- Maintain financial feasibility and balance;
- Are executable;
- Conform to legal requirements, rules, and policy

The FMB analysts review the submission for both technical and programmatic factors.

- The technical factors include things such as the proper preparation of all required exhibits, accurate pricing, accurate prior year execution data, and executability of programs.
- The programmatic factors also deal with executability but look primarily at whether the program or activity is in compliance with existing laws and regulations, meets the requirement of the DPPG, whether performance criteria are appropriate and accurate, and – for acquisition programs – if milestones are on track.

The review process is designed to provide resources for essential programs at the best cost. An inherent "downward bias" exists between the reviewing analyst and the cost estimators. This bias is in place, by design, to ensure that DoN goals are met. The DoN analyst sees what is viewed as a "cushion" by the activity or program manager as capricious pricing. The conflict between the reviewing analyst and submitting office will ensure that resources and programs are not lost, and remain in the Navy. In other words, if there is fat in the budget, the Navy would prefer to find and reallocate it toward other Navy requirements rather than have OSD or OMB find it and allocate it to other services or other government agencies. A few review criteria for select types of appropriations include:

- The Procurement appropriations will be reviewed for pricing and milestone schedules in the acquisition cycle. Unit costs, the production schedule, inventory requirements and sparing philosophies, and lead-time will be examined.
- The Operations and Maintenance appropriation review criteria will depend on the type of program. Cost data will be used to examine overhaul figures, fuel costs, labor costs, operations, medical care, distribution costs and real property maintenance.
- The Military Personnel appropriation is reviewed on an average cost basis, using average costs for pay and allowances for all ranks. Attrition, accession and the estimated number of personnel are weighed against the average costs. Permanent change of station (PCS) costs, bonuses and separation costs must be considered, as well.

Unfunded requirements may result from improper POM pricing or a lack of balance across the appropriations, and the Resource Sponsors must provide offsets from other programs to cover the shortfall. In other words, cut other programs to fund the unfunded requirement.

Programs will be reviewed for executability and balance. In other words, the program must be achievable in the time period of funds availability (executable) and the program must not be at the expense of all other programs (balance). Contract award dates, phasing of requirements, maintenance phasing, personnel requirements and production rates will be examined to ensure the program will execute in the budget year.

After an initial review and analysis of the material submitted in support of the budget estimates, each FMB analyst may schedule budget review sessions to review program details with representatives from BSOs and resource sponsors (RS). The primary purpose for these sessions is to obtain additional information on programs for which the justification contained in budget exhibits does not adequately support the budget estimates. The respective FMB division issues a schedule of budget review sessions for each appropriation/fund. Representatives from other interested offices (such as DON Program Information Center (DONPIC), and the offices of the Assistant Secretaries) are also invited to attend these sessions. The analyst conducting the session often provides questions in advance to facilitate the exchange of information at the session and to make BSOs and RSs aware of area of concern or potential budget marks.[60]

Issue Papers (or Marks)

After completing the review and analysis of the budget estimates contained in the submission, an FMB Issue Paper is prepared (if required) for each appropriation/fund or major sub-division thereof. The Issue Paper or Mark is issued when an analyst perceives a weakness in the budget, recommends adjustments to the budget estimates, and provides the rationale for these adjustments. Issue Papers will be prepared by cognizant FMB budget analysts (via the Issue Paper Generator[61]), issued by the appropriate division director, and posted to the Navy Headquarters Program/Budget Information System (PBIS) web site for viewing and/or downloading electronically. Unless a reclama (a response) to the Issue Paper is submitted, these adjustments become final decisions.

Issue Papers tend to fall in a few broad categories that directly relate to the technical and programmatic factors that are reviewed. Those categories include:

- Approval for Production
- Unfunded Requirements

[60] Budget Guidance Manual, May 2010, Part I-39
[61] Program/Budget Information System (PBIS) website, Issue Paper Generator found at: https://fmbweb1.nmci.navy.mil/cfdocs/IssuePapers/ipg_home.cfm?cache=off

- Pricing
- Program Executability
- PDM/PBD compliance or implementation
- Congressional Action
- Audit Savings
- Interappropriation Transfers
- Prior Year performance
- Outyear adjustments[62]

Reclama Process

Reclama procedures have been established to provide BSOs and other DON organizations an opportunity to respond to adjustments made in the FMB Issue Paper. If a reclama is submitted to a specific Issue Paper, then that Issue Paper is considered a tentative decision until the reclama is resolved. If no reclama is submitted, then the Issue Paper becomes a final decision.[63]

The reclama process is designed to address erroneous assumptions made by the reviewing analyst, and is not intended for the BSO to shift funds from one program to another. The reclama should address the Issue Paper, and correct any erroneous assumptions or errors. Issues outside of the Issue Paper should not be addressed, and only factual disagreements should be addressed. In other words*, emotions should remain out of the reclama*. A good reclama will address the logic and data used by the analyst that led them to conclude the mark was an appropriate adjustment.

The issuing analyst resolves most Issue Papers. If required, the branch head or division head will resolve the issue. However, not all Issue Papers can be resolved in this manner. Major Issues Meetings may be held with FMB and the BSO (and Resource Sponsor, as applicable), and are of a level that will possibly require the attention of the Secretary of the Navy. Prior to this, FMB discusses these issues with N8, the DCNO for Integration of Capabilities and Resources. Additionally, Program Budget Coordination Group (PBCG) meetings may be held throughout the review process with participation at the DASN and two-star level to resolve program and budget issues that arise during the review. The SECNAV has the final say on all Issue Papers in the DoN.

The outyears (in the program review) must be balanced along with the budget year (in the budget review). The final rebalancing will occur after intense review by the CNO, the CMC and final review by the SECNAV. The last step in the DoN Budget Review is the issuance of control totals for submission of budget estimates to OSD/OMB. Final decisions resulting from the Secretary of the Navy review are reflected in these fiscal controls, and no deviations from these

[62] Budget Guidance Manual, May 2010, Part I-42
[63] Budget Guidance Manual, January 2005, Part I-42

controls are allowed. The Navy budget is submitted to the SECDEF and is included in the DoD budget.

Schedule

Specific schedule for the various events in the budget review varies each year. The schedule is keyed to the need to submit the Navy budget in coordination with the OSD and OMB schedules. Normally the submission to OSD and OMB is required in mid-August timeframe. Specific dates are published in FMB Budget Guidance Memoranda that are posted in PBIS.

OSD and OMB Review

At this point, there is no longer a Navy budget, Air Force or Army budget – they become *one DoD budget*. Analysts from the Under Secretary of Defense, Comptroller (USD (C)) and the Office of Management and Budget (OMB) conduct an initial review of the material submitted in support of the budget estimates. The intent at the OSD/OMB level is to ensure that the submissions are executable, reflect proper balance between military departments for joint programs, accommodate final DoD fiscal guidance, and are supportable in subsequent review by Congress.

OSD/OMB will schedule hearings to review program details with representatives from the Military Departments. Prior to the hearings, the analysts will usually provide a list of questions to be discussed. These questions are passed to FMB, who in turn passes them to the BSOs, as appropriate. Once the hearings are complete, the analysts will then recommend adjustments (marks) to the budget estimates in the form of Program Budget Decisions (PBDs), Resource management Decisions (RMDs), Resource Decision Documents (RDDs) and Management Initiative Documents (MIDs). At the time of this writing, there is little guidance that delineates which document will be used to record the budget decision. Students need not get concerned about the various documents. It is sufficient to say that a decision will be made and it will be recorded or published on some type of document (PBD, RMD, RDD, MID).

Decision Documents (PBD/RMD/RDD/MID)

The OSD decision-making process focuses on the preparation, processing and promulgation of PBDs/RMDs/RDDs and, less frequently MIDs. These documents provide the Secretary of Defense an analysis of the funding requirements as requested by the components and also provide one or more alternative recommendations. PBDs/RMDs/RDDs are adjustments (i.e., Issue Papers, marks) recommended by OSD/OMB analysts that normally highlight problems with program milestones or funding, thus providing the SECDEF an opportunity to make appropriate adjustments to the budget submissions. PBDs/RMDs/RDDs are considered drafts until the Services have the opportunity to review and reclama.[64] MIDs may be issued to highlight reform or process improvement initiatives.

Reclamas are drafted by the respective BSO and are reviewed by FMB. The lead analyst will present the PBD/RMD/RDD/MID reclama to FMB and it will then be forwarded to OSD/OMB in a Coordination Memorandum. The OSD/OMB analysts will review the reclama and make any changes required to the draft PBD. The PBDs/RMDs/RDDs/MIDs are then finalized by the Undersecretary of Defense (Comptroller), and forwarded for signature, usually by the Secretary of Defense or Deputy Secretary of Defense.

Major Budget Issues (MBI) Meeting

If the components still have any outstanding issues with the PBDs/RMDs/RDDs/MIDs, then a Major Budget Issues (MBI) meeting will be scheduled with the SECDEF and the applicable component Secretary. Not all issues may be resolved at the MBI, and the SECDEF will take them forward when he meets with the President to discuss the OSD budget.

SECDEF Meeting with the President

The Secretary of Defense and the Director of OMB meet with the President to resolve any issues between OMB and OSD. After this meeting, OSD will issue PBDs that include the President's decisions in the Defense budget. The final product of this process is the President's Budget (PB or PresBud) submission to the Congress.[65]

Congressional Review Process

The Congressional Review Process, Budget Resolutions, Authorization and Appropriation were covered in Chapter 2. Students are referred to the Navy Budget Guidance Manual, Chapter 5, for more detail.

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[64] Budget Guidance Manual, May 2010, Part I-49
[65] Budget Guidance Manual, May 2010, Part I-53

Chapter 7: Appropriated Funds

Appropriations – Definition

An appropriation is the authority provided by an Act of Congress to incur obligations for specified purposes and to make payments out of the Treasury. Note that an appropriation is not money, it is the authority to place the government in a situation which will require the immediate or future payment of funds. Appropriations take many different forms based on their ***purpose, time, and amount*** characteristics (discussed later in this chapter). Appropriations are annual, multiple year, or no-year. The Department of the Navy receives appropriations via the Department of Defense Appropriations Act and in the Military Construction Appropriations Act.[66]

For an appropriation to be available for a legal expenditure of funds, all three of the following must be observed:

(1) purpose of the obligation or expenditure must be authorized;
(2) obligation must occur within the time limits prescribed by the Congress;
(3) obligation and expenditure must be within the amounts prescribed by the Congress.

Before an appropriation act is passed, it is normally preceded by an authorization act. Authorization acts authorize the programs and amounts to be provided by an appropriation, prescribe personnel end-strength numbers, and may also direct the submission of reports. The appropriation act provides the budget authority for appropriated fund activities. *It is important to understand that without an appropriation act, the authority to incur obligations does NOT exist.*

Appropriation Terminology

Obligation availability period. This is defined as the period during which obligations may be incurred as specified by the appropriation. At the end of this period, the appropriation "*expires*" and no new obligations may be made; only within-scope contract changes or valid obligation adjustments may be made. Not all appropriations have the same obligation availability period. For example, O&M has a one year period of availability, whereas RDT&E has a two year period of availability and procurement appropriations have a three year period of availability.

Any unobligated balances from expired appropriations retains the fiscal identity in an expired account at the component level.

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[66] Department of the Navy, Financial Management Policy Manual, NAVSO P-1000 Rev through Change 67, 12 December 2002, para 074000

Expenditure availability period. This is defined as the period beginning at the end of the obligation availability period (in other words, after the funds have expired), which extends for a period of five years. This applies to all appropriations. Simply stated, it is the period in which all outstanding obligations can be *liquidated* with matching expenditures. At the end of this period, the appropriation lapses (also referred to as closes or canceled) and any unexpended balances are returned to the Treasury general fund. When returned to the Treasury, those funds are no longer available for any obligation.

Readers are cautioned that this is not a precisely accurate term. Expenditures are not limited only to the expenditure availability period; they may post against an obligation any time after making that obligation. In fact, especially for expense type appropriations, the majority of funds will expend during the obligation availability period. Further, expenditures occasionally come in after the expenditure availability period. In these cases, the expenditure is paid from a current appropriation which carries the same purpose as the original obligation.

Open appropriation. This is defined as the obligation availability period plus the expenditure availability period. For example, Operations and Maintenance is open for a period of 6 years (1 year for obligation plus 5 years for expenditure), while Aircraft Procurement is open for a period of 8 years (3 years plus 5 years). See Figure 31 - Appropriation Terminology for an illustration of these terms.

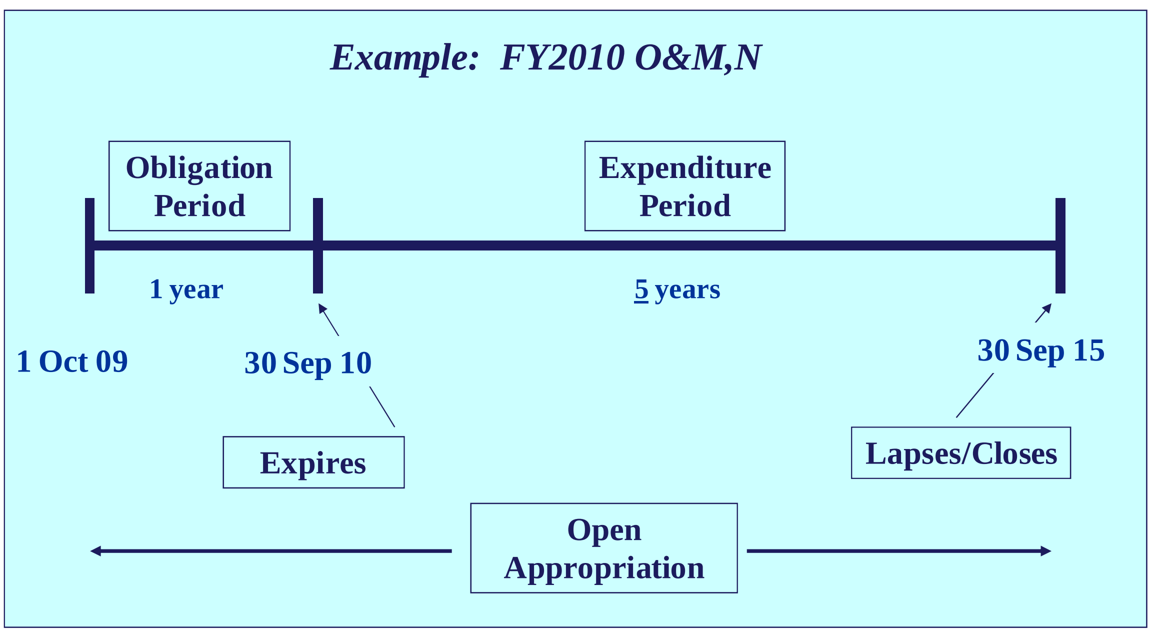

Figure 31 - Appropriation Terminology

A key point to remember is that when the appropriation lapses/closes, any outstanding and unliquidated obligations are canceled. Once cancelled, funds are no longer available for any purpose. If any valid adjustments or expenditures are required to liquidate a lapsed/closed appropriation, then they will be charged to *current* year funds, up to one percent of the fund authorization. Simply stated, failure to properly liquidate fiscal year 2003 O&M obligations could result in charges to your fiscal year 2009 O&M account. One percent may not sound like a significant amount, but one percent of the Navy's Operation and Maintenance (O&MN) dollars is roughly equal to $400,000,000. It adds up at the appropriation level where this is managed. Financial managers are cautioned not to wait until the last year of the expenditure availability period to reconcile these records…an ongoing obligation validation program is essential for accurate funds management.

<u>Transfer authority</u>. The intent of Congress is stated in the Authorization and Appropriations Acts. Funds may not be transferred from one appropriation to another (recall the purpose) without the approval of Congress. Congress gives the SECDEF general transfer authority for high priority requirements, and excludes using the MILCON appropriation. Transfer authority may involve moving funds from the Operations and Maintenance appropriation to the Military Personnel appropriation. Notification to OMB and Congress is required, however.

<u>Reprogramming authority</u>. The DoD is issued cumulative thresholds, by appropriation, for which the components may revise programs *within* appropriations. For example, the Navy may wish to move funds from one budget activity to another budget activity in the Military Personnel Navy appropriation. The thresholds and restrictions are specified in the Appropriations Act, and the appropriate committees (HAC and SAC, HASC and SASC) must be notified if the reprogramming is above the cumulative threshold amount.

<u>Budget authority</u> provided by an annual appropriation is referred to as New Obligation Authority (NOA). You may also have budget authority from prior years' appropriations, such as *unexpired* budget authority from a multiple year appropriation like aircraft procurement (APN) or research, development, test and evaluation (RDT&E). These are two of the three components of what is *called Total Obligation Authority*, or TOA. The third component of TOA is *reimbursable authority*. Reimbursables will be discussed in a later chapter, but are simply a lateral transfer of budget authority from one activity to another.

Appropriations Characteristics

All appropriations have three important characteristics. These characteristics are critical for any comptroller, financial manager, budget analyst, or anyone else who spends money in the government. You must consider these characteristics when spending funds or thinking about spending funds. If you remember nothing else in this course, a solid understanding of these characteristics can keep you and your Commanding Officer out of jail!

As mentioned earlier, these characteristics are called purpose, time, and amount (PTA). PTA will become near and dear to you in the financial management community, whether Army, Navy, Air Force or Marine. Now let's delve deeper into these concepts….

Purpose[67]

The most fundamental statute dealing with the use of appropriated funds is 31 U.S. Code Section 1301(a):

> "Appropriations shall be applied only to the objects for which the appropriations were made except as otherwise provided by law."

Since money cannot be paid from the Treasury except under an appropriation[68] and since an appropriation must be derived from an act of Congress, it is for Congress to determine the purposes for which an appropriation may be used. The statute prohibits charging authorized items to the wrong appropriation and unauthorized items to any appropriation. Think about that last statement…

Generally the language in an appropriations act is fairly clear, but not always. There are some established guidelines. For instance, a specific appropriation must be used to the exclusion of a more general appropriation that might otherwise have been viewed as available for the particular item. In addition, transfers between appropriations are prohibited without specific statutory authority, even if reimbursement is contemplated. Further, an agency cannot do indirectly what it is not permitted to do directly. Thus, an agency cannot use a contract to accomplish a purpose it could not do by direct expenditure.

So where does one look to find the authorized purpose of an appropriation – or perhaps more common – where does one look to determine which appropriation is proper for a given item of expense? The first place is to the appropriation act itself and the authorizing legislation. The student is referred to Chapter 4 of Principles of Appropriation Law (commonly referred to the as the GAO Red Book, due to its red cover) to read applications of the interpretation of appropriation language.

A few items are worth noting here. First, the relationship of an appropriation to the agency's budget request is an important factor in determining purpose availability. If a budget submission requests a specific amount of money for a

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[67] Much of this material is taken directly from Principles of Appropriation Law (commonly referred to as the GAO RedBook), Chapter 4.
[68] U.S. Constitution, Article I, Section 9

specific purpose, and Congress makes a specific line-item appropriation for that purpose, the purpose aspects of the appropriation are relatively clear and simple. The appropriation is legally available only for the specific object described. This is known as "specific authority."

If the appropriation is a general lump sum appropriation with broad object categories, there are two basic rules:

(1) where an amount to be expended for a specific purpose, which is <u>not otherwise provided for</u>, is included in a budget estimate, the appropriation is legally available for the expenditure even though the appropriation act does not make specific reference to it; and

(2) the inclusion of an item in departmental budget estimates for an expenditure, which <u>is otherwise prohibited</u> by law, and the subsequent appropriation of funds without specific reference to the item, does not constitute authority for the proposed expenditure or make the appropriation available for that purpose.

An example for each of these rules might bring clarity to the discussion. For rule (1) suppose you wanted to use O&M funds to purchase an aircraft. Under this rule, that would not be permitted because aircraft are provided for under the Aircraft Procurement appropriation. In other words, that item is specifically provided for in the Aircraft Procurement appropriation. A specific appropriation always trumps a general one. Rule (2) refers to items that may be included in a budget and later appropriated by Congress. Just because the item is in the budget and is approved does not mean one can break the law. Suppose you submitted a budget request for $50K to purchase the finest wine in the world for the budget officer. The budget was approved and appropriated. You still would not be able to purchase the wine as there are laws prohibiting the use of appropriated funds for gifts.

This brings us to the "necessary expense doctrine." Certainly, not every item of expenditure can and should be specified in an appropriations act. The spending agency has reasonable discretion in determining how to carry out the objects of the appropriation. This is the basis for the "necessary expense doctrine." Dating from a Comptroller General decision in 1927:

> "It is a well-settled rule of statutory construction that where an appropriation is made for a particular object, by implication it confers authority to incur expenses which are necessary or proper or incident to the proper execution of the object, unless there is another appropriation which makes more specific provision for such expenditures, or unless they are prohibited by law, or unless it is manifestly evident from various precedent appropriation acts that Congress has specifically legislated for certain expenses of the Government creating the implication that such expenditures should not be incurred except by its express authority."

While this sounds a bit legalistic, it boils down to a simple 3 part test…for the expenditure to be justified, it <u>must</u>:

(1) bear a logical relationship to the appropriation charged,
(2) not be prohibited by law, and
(3) not be otherwise provided for, that is, it does not fall within the scope of some other appropriation.

That is the bread and butter of the necessary expense rule. Readers should clearly understand and be able to apply this rule on a daily basis!

One final aid in determining the proper appropriation is the structure of the appropriation. All appropriations contain an inherent hierarchy of purpose. The first subdivision for all appropriations is the budget activity (BA). From there, each appropriation is a little different. For example, national defense appropriations break down as shown below in Figure 32 - Appropriation Taxonomy.

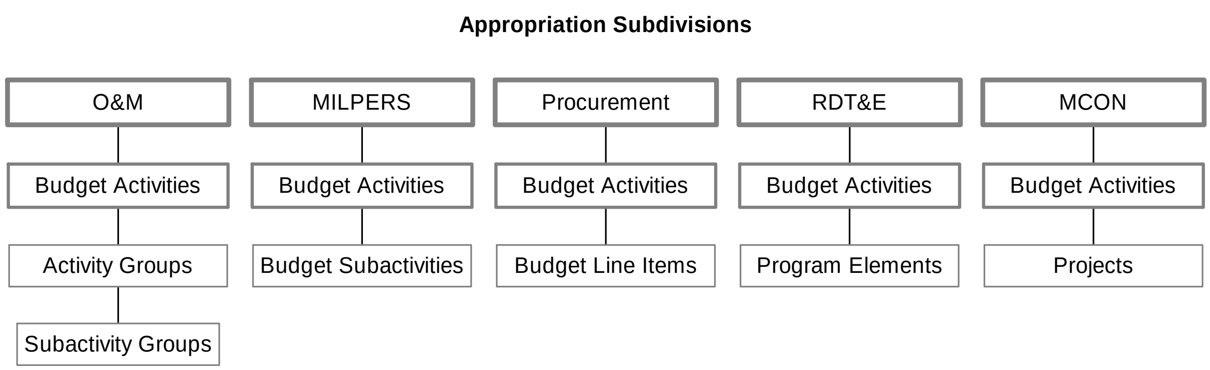

Figure 32 - Appropriation Taxonomy

- **Operations and Maintenance** budget activities include: Operating Forces, Mobilization, Training and Recruiting, and Administration and Service wide Support.
- **Military Personnel** budget activities include: Pay and Allowances of Officers, Pay and Allowances of Enlisted, Pay and Allowances of Midshipmen, Subsistence of Enlisted Personnel, Permanent Change of Station Travel, and Other Military Personnel Costs.
- **Aircraft Procurement** budget activities include: Combat Aircraft, Airlift Aircraft, Trainer Aircraft, Other Aircraft, Modification of Aircraft, Aircraft Spares and Repair Parts, and Aircraft Support Equipment and Facilities.
- **Other Procurement Navy** budget activities include: Ships Support Equipment, Communications and Electronics Equipment, Aviation Support Equipment, Ordnance Support Equipment, Civil Engineering Support Equipment, Supply Support Equipment, Personnel and Command Support Equipment and Spares and Repair Parts.

- **Procurement Marine Corps** budget activities include: Ammunition, Weapons and Combat Vehicles, Guided Missiles and Equipment, Communications and Electronics Equipment, Support Vehicles, Engineer and Other Equipment, and Spares and Repair Parts.
- **Research, Development, Test and Evaluation** budget activities include: Basic Research, Applied Research, Advanced Technology Development, Demonstration and Validation, Systems Development and Demonstration, RDTE Management Support, and Operational Systems Development.
- **Military Construction** budget activities include: Major Construction, Minor Construction, Planning, Supporting Activities, and Historical Projects.
- **Family Housing Operations** budget activities include: Mortgage Insurance Premiums, Operations, Leasing, Maintenance, and Interest Payments.
- **Family Housing Construction** budget activities include: Family Housing New Construction, Improvements, and Planning and Design.

Another aspect of the purpose characteristic is the **expense-investment threshold**. Congress sets the level at which an element of expense is large enough to be considered an investment. Investments are normally procured with investment-type appropriations (procurement, construction) while expenses are funded with expense-type appropriations (operations and maintenance, military personnel). Some appropriations are not so clear (RDT&E, Base Realignment and Closure (BRAC)). The FY03 Consolidated Appropriations Resolution, Public Law 108-7 of 20 Feb 2003 raised the expense-investment threshold from $100,000 to $250,000.

Thought must be given to ascertaining what is an investment or expense, linking the thought process to the purpose of the appropriation. Not all situations will be black and white, and the following are some examples of gray areas:

- Major service life extensions are financed with procurement dollars and extend the life of a weapons system.
- Depot and field level maintenance are routine and recurring requirements and extend the life of items, yet are funded in the Operations and Maintenance appropriation.
- Technology refreshments to improve the reliability or maintainability of an item are funded with O&M dollars. However, technology refreshments that extend the performance envelope are modifications, and therefore are investment costs. This one is very common and you can expect to see this in most commands as most commands have computers.
- When family housing units are built and outfitted, family housing construction costs shall fund the procurement of refrigerators, carpeting, shades, etc. When a refrigerator is to be replaced, it will be replaced with family housing *operations* dollars.
- For a military construction project, furniture items that are movable (collateral furnishings) and not a fixed part of the facility will <u>not</u> be funded with

construction dollars. These items will be funded as an expense (using O&M dollars) regardless of the aggregate cost (based on the unit cost).

- Minor construction (<$1.5M threshold) costs can be financed with O&M dollars and categorized as expenses up to $750K. MILCON would be used above $750K. Students should recognize that there are other exceptions and thresholds to using O&M and MILCON and should refer to 10 USC 2805 for more detail.[69]

Time[70]

The two basic "authorities" of appropriations are the authority to incur an obligations and the authority to make expenditures. An obligation is a binding commitment against an appropriation that will require expenditure at some later time. It's often referred to as a 'legal reservation of funds.' An expenditure is the actual disbursement of funds to pay an obligation. This section will discuss the limitations on the use of appropriations relating to time—when they may be obligated and when they maybe expended.

An 1870 Comptroller General ruling held that

> "Congress has the right to limit its appropriations to particular times as well as to particular objects, and when it has clearly done so, its will expressed in the law should be implicitly followed."

The placing of time limits on the availability of appropriations is one of the primary means of congressional control. By imposing a time limit, Congress reserves to itself the prerogative of periodically reviewing a given program or agency's activities.

When an appropriation is by its terms made available for a fixed period of time or until a specified date, the general rule is that the availability relates to the authority to obligate the appropriation, and does not necessarily prohibit payments after the expiration date for obligations previously incurred.

Appropriations can be categorized as annual, multiple year or no-year (continuing) for the time limits aspect. Annual appropriations can be used only for incurring obligations during the fiscal year specified in the appropriations act language. At the end of the obligation availability period, the appropriation is *expired* and is not available for new obligations. Examples of annual appropriations include Operations and Maintenance (O&M), and Military Personnel. These appropriations are incrementally funded, i.e., enough for one

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[69] Title 10, U.S. Code, section 2805, http://www.law.cornell.edu/uscode/html/uscode10/usc_sec_10_00002805----000-.html

[70] Much of this material is taken directly from Principles of Appropriation Law (commonly referred to as the GAO RedBook), Chapter 5.

year's worth of operations. Annual appropriations are available only to meet bona fide needs of the fiscal year for which they were appropriated.

The *bona fide needs rule* simply states that a fiscal year appropriation may be obligated only to meet a legitimate, or bona fide, need arising in, or in some cases arising prior to but continuing to exist in, the fiscal year for which the appropriation was made. Bona fide need questions arise in many forms. An agency may wish to enter into or modify a contract or make some other obligation or expenditure, the question being which fiscal year to charge. The question may be whether an obligation previously recorded was a proper charge against that fiscal year's appropriation. An agency may have taken certain actions that it should have recorded as an obligation but did not; when the time for payment arrives, the question again is which fiscal year to charge. These are all facets of the same basic question—whether an obligation, proposed or made, recorded or unrecorded, voluntarily incurred or imposed by operation of law, bears a sufficient relationship to the legitimate needs of the period of obligation availability of the appropriation charged or sought to be charged.

While the rule itself is universally applicable, determination of what constitutes a bona fide need of a particular fiscal year **depends largely on the facts and circumstances of the particular case**. A common application of the rule in this context is that an appropriation is not available for the needs of a future year. For example, suppose that, as the end of a fiscal year approaches, an agency purchases a truckload of pencils when it is clear that, based on current usage, it already has in stock enough pencils to last several years into the future. It would seem apparent that the agency was merely trying to use up its appropriation before it expired, and the purchase would violate the bona fide needs rule. The bona fide needs rule does not prevent maintaining a legitimate inventory at reasonable and historical levels, the "need" being to maintain the inventory level so as to avoid disruption of operations. The problem arises when the inventory crosses the line from reasonable to excessive.

Bona fide need questions also frequently involve transactions which cover more than one fiscal year. In the typical situation, a contract is made (or attempted to be made) in one fiscal year, with performance and payment to extend at least in part into the following fiscal year. The question is, which fiscal year should be charged with the obligation? In this context, the rule is that, in order to obligate a fiscal year appropriation for payments to be made in a succeeding fiscal year, the contract imposing the obligation must have been made within the fiscal year sought to be charged, and the contract must have been made to meet a bona fide need of the fiscal year to be charged.

The bona fide needs rule applies to multiple-year as well as annual appropriations. In other words, an agency may use a multiple-year appropriation for needs arising at any time during the period of availability. An argument can be made, not wholly without logic, that a multiple-year appropriation can be obligated at any time during its availability, but only to meet a bona fide need of the year in which the funds were appropriated. Suppose, for example, that an agency receives a two-year appropriation every year. For FY 2007, it receives an appropriation available through FY 2008; for FY 2008, it receives an appropriation available through FY 2009, and so on. It is possible to apply the bona fide needs rule to require that the FY 2007 appropriation be used only for needs arising in FY 2007, although obligation may occur any time prior to the end of FY 2008. The Comptroller General specifically rejected this approach stating, “There is no requirement that 2-year funds be used only for the needs of the first year of their availability.” In the same ruling, however, the Comptroller General stated that an agency may, as a matter of policy, impose such a restriction for management reasons. Current Navy policy is to treat RDT&E,N funds as if they were annual funds in scenarios such as the one presented above. As such, RDT&E normally falls under the incremental funding policy (discussed in chapter 6), although there are exceptions.

Another apparent violation of the bona fide needs rule and the requirement to incrementally fund severable work is “Section 801 authority” named for the section of the FY1998 Defense Authorization Act (which amends 10 USC Section 2410a.) This law permits the obligation of funds for up to 12 months of severable work, even when that work extends beyond the obligation availability period of the funds. There are some specific requirements under the Federal Acquisition Regulation (FAR) which must be met in order to use this authority, but it is available for those who often contract for severable service contracts using annual funds and wish to avoid the common problems that result from fiscal year transition and continuing resolutions.

The last paragraph employed an important term that should be clearly defined. The paragraph referred to severable service contracts. What is meant by *severable* and why is that an important concept? According to the Comptroller General, “The determining factor for whether services are severable or entire is whether they represent a single undertaking.” (GAO 2004: 5-24) Ongoing services, such as grounds keeping, engineering and logistics support, and leases are considered severable since the work done in one period may be separated or severed from the work done in another period and the government still received benefit for the work previously performed. The functional opposite of severable is *entire*. A task or item of expense is said to be entire if it represents a single undertaking: overhauling a pump, building a missile, constructing a building, or purchasing a computer are all entire tasks. A half-overhauled pump is of no value, a partially manufactured missile meets no need of the government – the government’s needs are not met by a segment of the work.

The Comptroller General put it this way,

> …there is a fairly simple test that is often helpful in determining whether a given service is severable or nonseverable. Suppose that a service

> contract is to be performed half in one fiscal year and half in the next. Suppose further that the contract is terminated at the end of the first fiscal year and is not renewed. What do you have? In the case of a window-cleaning contract, you have half of your windows clean, a benefit that is not diminished by the fact that the other half is still dirty. What you paid for the first half has not been wasted. These services are clearly severable. Now consider a contract to conduct a study and prepare a final report. If this contract is terminated halfway through, you essentially have nothing. The partial results of an incomplete study, while perhaps beneficial in some ethereal sense, do not do you very much good when what you needed was the complete study and report. Or suppose the contract is to repair a broken *frammis*. If the repairs are not completed, certainly some work has been done but you still don't have an operational *frammis*. The latter two examples are nonseverable." (GAO 2004: 5-28)

This concept of severability versus entirety has significant financial implications. In brief, tasks which are severable are incrementally funded in annual installments; tasks which are entire are fully funded regardless of how long they take to accomplish. Incremental and full funding were discussed in chapter 6.

Naturally, the bona fide needs rule does not apply to no-year funds, such as working capital funds. Chapter 5 of the GAO Redbook contains many examples and cases related to the time aspect of appropriations. It's important to remember that bona fide need rule applies to the **time** portion of the PTA analysis. Students frequently get confused by the terminology and want to associate bona fide need with the **purpose** aspect of PTA.

Amount[71]

The two preceding sections have discussed the purposes for which appropriated funds may be used and the time limits within which they may be obligated and expended. This section will discuss the third element of the concept of the "legal availability" of appropriations-restrictions relating to amount. It is not enough to know what you can spend appropriated funds for and when you can spend them. You must also know how much you have available for a particular object.

Under the "separation of powers" doctrine established by the Constitution, Congress makes the laws and provides the money to implement them; the executive branch carries out the laws with the money Congress provides. Under this system, Congress must have the "final word" as to how much money can be spent by a given agency or on a given program. In exercising this power, Congress may give the executive branch considerable discretion within broad limits, but it is ultimately up to Congress to determine how much the executive branch can spend. In applying this theory to the day-to-day operations of the

[71] Much of this material is taken directly from Principles of Appropriation Law (commonly referred to as the GAO RedBook), Chapter 6.

federal government, it should be readily apparent that restrictions on purpose, time, and amount are very closely related. Again, the Antideficiency Act is one of the primary "enforcement devices." Its importance is underscored by the fact that it is the only one of the funding statutes to include both civil and criminal penalties for violation. This is certainly an area that comptrollers and non-comptrollers want to pay close attention to.

In this respect, the legal restrictions on government expenditures are different from those governing your spending as a private individual. For example, as an individual, you can buy a house and finance it with a mortgage that may run for 25 or 30 years. Of course you don't have enough money to cover your full legal obligation under the mortgage. You sign the papers on the hope and assumption that you will continue to have an income. If your income stops and you can't make the payments, you lose the house. The government cannot operate this way. The main reason why is the Antideficiency Act.

If the Antideficiency Act's prohibition against over obligating or overspending an appropriation is to be at all meaningful, agencies must be restricted in the appropriations Congress provides. The rule prohibiting the unauthorized "augmentation" of appropriations is thus a crucial complement to the Antideficiency Act.

In addition to the Antideficiency Act, Congress may wish to designate, or "earmark," part of a more general lump-sum appropriation for a particular object, as a maximum, a minimum, or both. These tools are called ceilings, floors, and fences. Students can think of these terms as they relate to a house. The ceiling is the highest point in the house or the maximum amount that can be spent on a particular item. Floors are the opposite. Floors are the lowest point in the house, or the minimum amount to be spent on a particular item. Fences protect the home (at least theoretically!) and restrict who enters or exits the perimeter. In financial terms, fences restrict funds from moving in or out of a particular account.

By and large, the so-called Antideficiency Act is the major law by which Congress exercises its constitutional control of the public purse. In its current form, the law prohibits:

1. Making or authorizing an expenditure from, or creating or authorizing an obligation under, any appropriation or fund in excess of the amount available in the appropriation or fund unless authorized by law (31 USC Sec. 1341(a)(1)(A));
2. Involving the government in any contract or other obligation for the payment of money for any purpose in advance of appropriations made for such purpose, unless the contract or obligation is authorized by law (31 USC Sec. 1341(a)(1)(B));
3. Accepting voluntary services for the United States, or employing personal services in excess of that authorized by law, except in cases of

emergency (as defined in the law) involving the safety of human life or the protection of property (31 USC Sec. 1342); and
4. Making obligations or expenditures in excess of an apportionment or reapportionment, or in excess of the amount permitted by agency regulations (31 USC Sec. 1517 (a)).

The key provision of the Antideficiency Act is 31 U.S.C. § 1341 (a)(1):

"(a)(1) An officer or employee of the United States Government or of the District of Columbia government may not–

"(A) make or authorize an expenditure or obligation exceeding an amount available in an appropriation or fund for the expenditure or obligation; or

"(B) involve either government in a contract or obligation for the payment of money before an appropriation is made unless authorized by law."

While 31 USC Section 1341 refers to exceeding the appropriation level, comptrollers and financial managers (and Commanding Officers!) should be reminded that section 1517 is even more important as that relates to their specific portion or sub-allocation of the appropriation (the apportionment.) This is what most defense personnel fear the most and rightfully so!

It is easy to say that the Antideficiency Act prohibits you from obligating a million dollars when you have only half a million left in the account (31 U.S. Code Section 1517(a) prevents you from overspending an allotment or allocation), or that it prohibits you from entering into a contract in September purporting to obligate funds for the next fiscal year that have not yet been appropriated. However, many of the situations that actually arise from day to day are not quite that simple.

It is imperative to record valid obligations on a timely basis. Assuming obligations are recorded properly and are valid obligations, an over-obligation in the records is prima facia evidence of an Anti-Deficiency Act violation. Of course, there could be errors and mis-posted transactions that would relieve the responsible officer of accountability. Agencies are required to record all obligations and expenditures in a timely manner and Anti-Deficiency Act violations are considered "real-time" violations…they do not solely occur when accounts are balanced. Thus, failure to record a valid obligation does not relieve one of responsibility for violating the Act.

Another term connected with fiscal law discussion surrounds the term "personal services." It is worth mentioning how we define the term personal services. Personal services are defined in the Federal Acquisition Regulation, paragraph 37.104. The regulation indicates that personal service contracts are characterized by the employer-employee relationship it creates between the government and the contractor's personnel. Government is normally required to obtain employees by direct hire under civil service laws. Obtaining personal services by contract, rather than direct hire, circumvents those laws unless Congress has specifically authorized such activity.[72] Students should be aware that personal services are prohibited by the FAR, which is a tool that Congress uses to control how we spend funds.

Antideficiency Act Violations

Many 31 U.S. Code Section 1517(a) violations occur as a result of violation of 31 U.S. Code Section 1301(a). If funds are used improperly (color of money violation), the accounting records must be adjusted. If during the process of adjustment, sufficient funds do not exist to make the adjustment and charge the correct appropriation, at this point a violation of 31 U.S. Code Section 1517(a) has occurred.[73]

Common violations occur when:

- Obligations exceed fund authorizations for appropriated funds
- When obligations exceed cost authority for working capital funds
- Accepting a reimbursable document and incurring costs in excess of the funds authorized on the reimbursable document
- Using O&M dollars in excess of the $750,000 minor construction limit (can't build in several stages to circumvent the $750,000 limit). If this is exceeded, MILCON funds must be used for the entire project including the planning and design although O&M funds may be available.
- Using family housing dollars for repairs in excess of the Congressionally established statutory limit without prior approval.

Here are some possible violations of the Antideficiency Act, taken from the FMR.

- While making improvements to a waste storage facility, the activity used Operations and Maintenance funds in excess of the statutory minor construction limitation.
- An activity arranged for a lease to obligate and pay for a subsequent year's 12-month lease with current year Operations and Maintenance funds. You can't obligate the government for the payment of money before the appropriation is available.
- An activity used family housing operations and maintenance funds in excess of the Congressionally mandated limit without prior approval.

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[72] Federal Acquisition Regulation Homepage, http://www.acquisition.gov/far/

[73] Although every violation of 31 U.S.C. Section 1301(a) is not automatically a violation of the Antideficiency Act, and every violation of the Antideficiency Act is not automatically a violation of 31 US.C. Section 1301(a), cases frequently involve elements of both. Thus, expenditures in excess of an available appropriation violates both statutes. The reason the purpose statute is violated is that, unless the disbursing officer used personal funds, he or she must necessarily have used money appropriated for other purposes.

- A funds holder erroneously distributed more funds than available. Activities receiving the funds incurred obligations and expenditures in excess of the amount made available to the funds holder, but below the amount distributed to them. The funds holder incurred a violation of the Antideficiency Act.
- Making obligations or expenditures that do not provide for a bona fide need of the period of availability of the funds, and the correct funding is not available.
- Over obligating reserve component personnel accounts.

Persons causing violations of the Antideficiency Act can be subject to disciplinary action such as suspension without pay and removal from office. A person who knowingly or willfully causes a violation is subject to fines and imprisonment.

An Example

One can see from the following Congressional language how the principles of time, duration, and amount interact:

"For expenses, not otherwise provided for, necessary for the operation and maintenance of the Navy and the Marine Corps, as authorized by law; and not to exceed $_____ can be used for emergencies and extraordinary expenses, to be expended on the approval or authority of the Secretary of the Navy, and payments may be made on his certificate of necessity for confidential military purposes. ...to remain available for obligation until September 30, 20___; provided, . . ."

With respect to purpose, one can clearly see the necessary expense doctrine "For expenses… necessary…as authorized by law" and the intent of the appropriation both general "for the operation and maintenance of the Navy and Marine Corps…" and specific, "provided…" With respect to time, "to remain available for obligation until…" And with respect to amount, "and not to exceed $___".

Continuing Resolution Authority (CRA)

Annual appropriations are often not passed prior to 1 October. In the event Congress does not pass the annual appropriations bills by 1 October they are to enact a *Continuing Resolution Authority (CRA)*. The CRA provides funding as a rate of spending as opposed to an amount of funding. CRAs are intended to provide "stopgap" spending until the regular appropriations can be passed. They are levied with various restrictions (i.e., no new starts) so the intent of Congress is not violated. The President must sign the CRA so it will become law. Lastly, in the event that annual appropriations are not passed by 1 October and a CRA has not been enacted, the authority to incur obligations does <u>not</u> exist for appropriated fund activities. An example of CRA language (from one of the CRAs in the first days of Fiscal Year 2003):

"Current rate is defined as the net amount enacted in FY 2002 (plus supplementals and minus rescissions), plus unobligated balances carried forward from FY 2001 (if any), minus unobligated balance at the end of FY 2002 (if any). This amount is multiplied by the lower of: the percentage of the year covered by the continuing resolution (the prorata rate), or the historical seasonal rate of obligations for the period of the year covered by the continuing resolution (the seasonal rate). Furthermore, ..."

Summary

Provided below in Figure 33 - Appropriation Characteristics is information about the most common Defense appropriations.

Appropriation	Service Abbrev.	Length of Obligation Period	Examples	Properties	Budget Activities Funded
Operations and Maintenance	O&MN O&MMC O&MA O&MAF	1 year	Admin expenses, labor charges, TAD travel, spare parts, depot maintenance, fuel	Used for daily operations and expenses, minor construction up to $750K	Operating forces, training and recruiting, administration and support
Military Personnel	MPN RPN MPMC MPMCR	1 year	Officer and enlisted personnel salaries, bonuses, PCS moves	Used for salaries, training, bonuses, PCS moves, allowances	Officer pay, enlisted pay, allowances, PCS travel, midshipmen
Research, Development, Testing and Evaluation	RDT&EN	2 years	Expenses for developing new technology, conducting basic research	Used for the development of new or improved capabilities until ready for operational use	Advanced technology, strategic programs, technology base, tactical programs
Other Procurement	OPN	3 years	Purchasing equipment or conducting modernization greater than $250K	Used to procure equipment not funded by Operations and Maintenance funding	Ships support equipment, ordnance equipment, electronic support equipment, spares and repair parts
Procurement Marine Corps	PMC	3 years	Purchasing equipment, weapons and munitions greater than $250K	Used to procure equipment not funded by Operations and Maintenance funding	Ammunition, vehicles, spares and repair parts
Aircraft Procurement	APN APAF	3 years	Procuring planes, major mods, initial spares, support equipment	Used for the acquisition of initial or additional aircraft and related equipment	Combat aircraft, trainer aircraft, aircraft spares and repair parts
Weapons Procurement	WPN	3 years	Procuring missiles	Used for the acquisition of initial or additional weapons	Missiles, torpedoes, ammunition, spares or repair parts
Military Construction	MCON	5 years	Building facilities on a base or installation, acquiring land	Used for the construction, acquisition or installation of permanent facility engineering command	Major construction (> $1.5M), minor construction (up to $1.5M), planning, historical projects
Family Housing Operations	FHOPS	1 year	Maintenance of family quarters	Operations of quarters, leasing and maintenance	Operations, leasing, maintenance, interest payments, insurance premiums
Family Housing Construction	FHCON	5 years	Construction of family quarters	Construction of quarters and improvements to existing quarters	New construction, improvements and design
Shipbuilding and Conversion	SCN	5 years	Building or modifying ships, submarines and other craft	Construction of new ships and conversion of existing ships	FBM ships, amphibious ships, mine warfare ships, other ships
Base Realignment and Closure	BRAC	No year	Closure or realignment of shore infrastructure	One time, non-routine operating and investment costs for closure or realignment	MCN, family housing, environmental, ops and maintenance, military personnel, homeowner's assistance

Figure 33 - Appropriation Characteristics

Chapter 8: Reimbursables and Support Agreements

Overview

This section examines reimbursable support agreements, and the two major types of reimbursable documents: the Project Order and the Economy Act Order[74]. A reimbursable situation occurs when an activity has a requirement for goods or services and is not self-sufficient in that area. The activity instead calls on another activity that is so equipped. One simple example of a reimbursable situation is a ship while in port renting vehicles from a Facility Engineering Command. A reimbursable situation has a customer-provider relationship and reimbursable arrangements are analogous to contracts. DoD Instruction 4000.19 governs interservice and intragovernmental support, a basic tenet of which is "DoD activities shall provide requested support to other DoD activities when the head of the requesting activity determines it would be in the best interest of the United States Government, and the head of the supplying activity determines capabilities exist to provide the support without jeopardizing assigned missions."[75]

The requiring activity (customer) may issue a reimbursable work order to another activity outside of the major command (provider) for the desired goods or services. Since organizations cannot contract with themselves, reimbursable funding documents are not to be issued to activities within the same major command – the major command should adjust the activities' budgets accordingly.

Support is reimbursable only to the extent that the support provided to the receiver increases the provider's *direct costs*, i.e., only incremental direct cost can be reimbursed.[76] Indirect costs are not to be charged, nor are common support costs also known as general and administrative (G&A) costs. In other words, the costs must be directly attributable to the support provided, must be measurable and the provider must not be mission (direct) funded to perform the requested services. Suppliers of interservice and intragovernmental support are permitted to waive reimbursement from receivers who use or benefit from available support without appreciably increasing the supplier's costs (i.e., revenues would be less than the anticipated expense of billing and disbursing funds).

Of note in reimbursable arrangements, the supplying activity is required to perform at least 51%[77] of the work. The philosophy being that if the supplying activity cannot perform most of the work, they should not have accepted the work

[74] While this section of the chapter is written from the perspective of a mission-funded customer and supplier, these same reimbursable agreements apply to the Working Capital Fund. What differs is not the nature of the agreement, but the basis and amount for reimbursement.
[75] DoDI 4000.19 of August 1995, paragraph 4.3.
[76] Ibid, paragraph 4.6.
[77] DoD FMR, Volume 11A, chapter 2, paragraph 020515.

in the first place. If the supplying activity expects to contract out for part of the effort, it is common practice for the customer to finance the effort in two parts, one for the contracted effort (as a Request for Contractual Procurement, discussed later in this section) and one as the reimbursable order.

Because reimbursable situations result in a lateral transfer of budget authority from the customer to the provider, providers are not to request direct appropriated funding for the costs incurred. Reimbursable authority is included as part of Total Obligation Authority (TOA) and, to the extent they are known in advance, must be documented in the budget estimate submission process. Reimbursable amounts are to be kept separate and accounted for separately from operating budgets.

Service Agreements, Support Documentation and Definitions

DoD Instruction 4000.19 and the FMR, Volume 11A, provide the guidance for entering into a reimbursable situation. Any support agreement, like a contract with a private party, should be documented in a manner that ensures the interests of both parties are protected. There are several ways to document these agreements, depending on who the parties are and the nature of the agreement.

Interservice Support. Interservice support is that provided within the Department of Defense. The head of the requesting activity determines if it is in the best interest of the U.S. Government and the head of the supplying activity determines capabilities exits to provide the support without jeopardizing assigned missions. The quality of support services provided to other DoD activities shall be equivalent to the quality of support the supplier furnishes to its own mission, unless otherwise requested or approved by the receiver.[78]

Intragovernmental Support. Intergovernmental support is that provided between a DoD and non-DoD federal activity. DoD activities may enter into support agreements with non-DoD Federal activities when funding is available to pay for the support, it is in the best interest of the United States Government, the supplying activity is able to provide the support, the support cannot be provided as conveniently or cheaply by a commercial enterprise, and it does not conflict with any other agency's authority.[79] The determination of acceptability for entering into an intragovernmental reimbursable situation must be made at the flag officer, general officer or Senior Executive Service (SES) level. Reimbursement charges for support provided by DoD activities to non-DoD federal activities shall be determined the same way as reimbursement charges are determined for other DoD activities.

[78] DoDI 4000.19, 9 August 1995, paragraph 4.3
[79] Ibid, paragraph 4.4

Memorandum of Agreement (MOA). A Memorandum of Agreement is a memorandum that defines general areas of conditional agreement between two or more parties, e.g., one party will provide services while the other party provides material support. MOAs for *recurring reimbursable support* should be supplemented with a Support Agreement that defines the support, basis for reimbursement for each category of support, the billing and payment process, and other terms and conditions of the agreement.[80]

Memorandum of Understanding (MOU). A Memorandum of Understanding defines general areas of understanding between two or more parties and explains what each party plans to do; however, what each party does is not dependent on what the other party does (e.g., does not require reimbursement or other support from the receiver.)[81]

Broad areas of recurring interservice and intragovernmental support not requiring reimbursement should be documented with a MOA or MOU, as applicable. Recurring support that requires reimbursement should be documented on the DD Form 1144, "Support Agreement."

No-cost agreements with city or county activities and non-profit organization should be executed via a MOA or MOU. Agreements that would require reimbursement with a non-DoD activity, city, county or state must be executed with a contract.

Support Agreement. An agreement to provide recurring support to another DoD or non-DoD activity should be documented on a Support Agreement, DD Form 1144. Support Agreements define the support to be provided by one supplier to one or more receivers, and specify the *basis* (i.e., cost per square foot) for reimbursement, establish the billing and reimbursement process, and specify other terms and conditions of the agreement.[82]

It is important to note that none of the aforementioned documents provide the funding but are simply supporting documents. Reimbursements must be executed with either a NAVCOMPT Form 2275 (within the DoN) or via the Military Interdepartmental Purchase Request (MIPR) DD Form 448 (between DoD components and between other federal agencies).

Reimbursable orders take one of two basic forms, a Project Order or an Economy Act order. Both arrangements are based in federal statute and have unique characteristics.

[80] DoDI 4000.19, 9 August 1995, paragraph E2.1.10
[81] Ibid., para. E2.1.11
[82] Ibid. para, E2.1.12.

Project Order (PO)

Project Orders are authorized under the Project Order Law, 41 U.S. Code Section 23. A Project Order (PO) is a definite and specific order issued for the production of material or for repair, maintenance or overhaul. A PO is similar to a private sector contract. POs are to be fully funded from current obligation authority and may cross fiscal years, assuming the bona fide needs rule is met. (If RDT&EN funds are used on a Project Order it may be incrementally funded.) Work must commence within a "reasonable" amount of time upon acceptance of the order and that is normally within 90 days; there is no need to begin the work in the year the PO is issued so long as it begins within this reasonable time. [83] Project Orders may be issued under a fixed price or cost reimbursement basis. POs are subject to the same fiscal limitations that are contained within the appropriation from which they are funded. Work must cease when the funds are exhausted (or work is complete, which ever comes first) and may not recommence until additional funds are provided. Antideficiency Act responsibility may be levied upon the reimbursable amount and if so, will be specified on the reimbursable funding document.

To determine whether a PO can finance the order, it must be determined if the work is severable or non-severable. If the work is *non-severable*, then a PO can finance the work; otherwise, an Economy Act Order (EAO) should be used. An example of a non-severable task would be for the overhaul of an aircraft engine. The engine must be returned in operating condition, and the aircraft engine consists of hundreds of components that must be individually repaired.[84] *Severable* tasks would include custodial services, trash removal, routine maintenance, training, or a level of effort contract (i.e., 100 hours). Refer back to chapter 7 for further definition of severable.

[83] DoD Financial Management Regulation, Vol. 11A, Chapter 2, paragraph 020510.
[84] DoDI 4000.19 of August 1995

Economy Act Order (EAO)

Economy Act Orders (EAOs) are also known as work requests and are authorized by the Economy Act, Title 31 USC Sections 1535 and 1536. EAOs are used for normal, routine, day-to-day operations such as custodial services, trash and garbage removal, routine maintenance, level of effort contracts and all severable efforts. An example would be to issue an EAO to the local Facility Engineering Command to obtain janitorial or landscaping maintenance services.

Before engaging in an interagency (between DoD and a non-DoD activity) Economy Act Order, the order must be supported by a Determinations and Findings (D&F) that it is in the best interest of the government and the goods or services cannot be obtained as conveniently from private sources. D&F determinations can be as simple as a memorandum for the record. No D&F determination is required for intra-agency (between two DoD activities) acquisitions of goods and services.[85]

EAOs are issued each year since the funds expire with the appropriation. That is, funding cannot carry-over into the new fiscal year. Work stops when the funds expire (or work/service is complete, whichever comes first.) As with POs, the restrictions associated with the financing appropriation apply to the EAO and the supplying activity must conform to those rules.

Request for Contractual Procurement (RCP)

A third type of support agreement is a Request for Contractual Procurement (RCP). This is not a reimbursable agreement since there is no transfer of budget authority. A RCP is a request for the supplier activity to enter into a contractual arrangement with a third party directly citing the customer's accounting line. An example of a RCP is an activity issuing an RCP to the local Fleet & Industrial Supply Center (FISC) to contract for cellular telephone service. The FISC uses the customer's line of accounting and contracts the services out to a private contractor. No lateral transfer of budget authority has occurred, nor will any accounting status reports be generated during the accounting cycle. The private contractor will charge the customer's account directly.

RCPs are done via the NAVCOMPT Form 2276 (within the Navy) or using the Military Interdepartmental Purchase Request (MIPR).

Figure 34– Reimbursable Summary is provided as a one page summary of POs, EAOs, and RCPs. This is a good study guide and quick reference.

[85] OASN (FM&C) memorandum, Fiscal Policy Associated with the Requirement for a Determination and Findings (D&F) Document Supporting an Economy Act Order, 1 April 2010

	Project Order (reimbursable)	Economy Act Order (reimbursable)	Direct Cite/ RCP (not reimbursable)
Task	Non-severable	Severable	Either
How Funded?	Full funding (except R&D)	Incremental Funding	Depends on Task
Expire or Carry-over?	Carryover	Expire at the end of the fiscal year. No carryover.	Must be obligated before they expire
Customer Obligation	When work is accepted	When work is accepted	When contract is signed
51% rule	Applies (per FMR)	Applies (per DoN policy)	N/A
Work ceases	When funds run out or work is complete, whichever comes first	When funds expire or work is complete, whichever comes first	Per contract terms

Figure 34– Reimbursable Summary

NAVCOMPT Form 2275

The NAVCOMPT Form 2275 may be used as either a PO or EAO and is used between Navy activities (i.e., Navy to Navy, or Navy to Marine Corps). It is not to be used for requesting local purchase, contractual procurement or requesting material from stock.

Military Interdepartmental Purchase Request (MIPR)

The MIPR (DD Form 448) is a multi-purpose document that is used between federal agencies and DoD components (i.e., Navy to Army, or Navy to National Aeronautics & Space Administration (NASA)). The MIPR can be used as a PO, an EAO, an RCP or a combination of the three.

Overview of the Reimbursable Accounting Cycle

The requesting activity initiates the process by submitting a reimbursable work order either as a Project Order (PO) or an Economy Act Order (EAO) as described above.

From an accounting perspective, prior to acceptance of the reimbursable order by the performing activity, the requesting activity has committed its funds. The providing activity decides whether to accept or reject the request based on its available capabilities. Two very important conditions must be met for all POs and EAOs requested and accepted:

- A bona fide need for the work requested must exist in the fiscal year the reimbursable order is issued
- At least 51 percent of the work requested must be performed by the performing activity with in-house resources (for POs). That is, the performing activity cannot simply contract out the work requested.

The provider must accept or reject the reimbursable order within five days and forward it to the requester. Upon acceptance of the reimbursable order by the performing activity, the requesting activity's funds become obligated. The performing activity receives increased budget authority. They do not receive funds until after the work is complete and the customer reimburses the provider.

The requesting activity's Authorization Accounting Activity (AAA, a.k.a. DFAS site such as DFAS Cleveland) will "reserve" obligation authority in an amount equal to the authorized dollar value of the reimbursable work order to pay for services to be rendered by the performing activity. This action reduces the amount of obligation authority that the requesting activity has available for other purposes.

The performing activity forwards a copy of the accepted funding document to its AAA to increase its obligation authority by the same amount in anticipation of "payments" to be received from the requesting activity. Upon acceptance of a reimbursable order, the performing activity establishes one or more Job Order Numbers and a reimbursable account. As work is performed, the performing activity consumes its own resources then seeks reimbursement from the receiver through periodic billings. The performing activity charges these costs against the appropriate Job Order Number(s) (JON) and forwards this information to its AAA.

Costs are charged using a report on the Status of Reimbursables (NAVCOMPT Form 2193) when both the supplier and receiver are naval activities. Performing activities are required to monitor the status of reimbursables using the NAVCOMPT Form 2193. This report is prepared by the performing activity's AAA on a quarterly or monthly basis and contains information on amounts authorized, obligated and billed. It is also the official document used for reporting unused funds and returning any excess funds to the grantor. The performing activity's AAA then prepares and transmits the billing (NAVCOMPT Form 2277) to the requesting activity's AAA.

The billing serves to reduce the balance of available reimbursable funds as work is performed. Upon receipt of the bill, the requesting activity's AAA will record an expenditure that immediately reduces the obligation authority of the performing activity by the amount of the billing. The "payment" is usually a transfer of obligation authority and not an exchange of cash when both the requesting activity and performing activity are federal agencies. See Figure 35 - Reimbursable Accounting Cycle for a graphical representation.

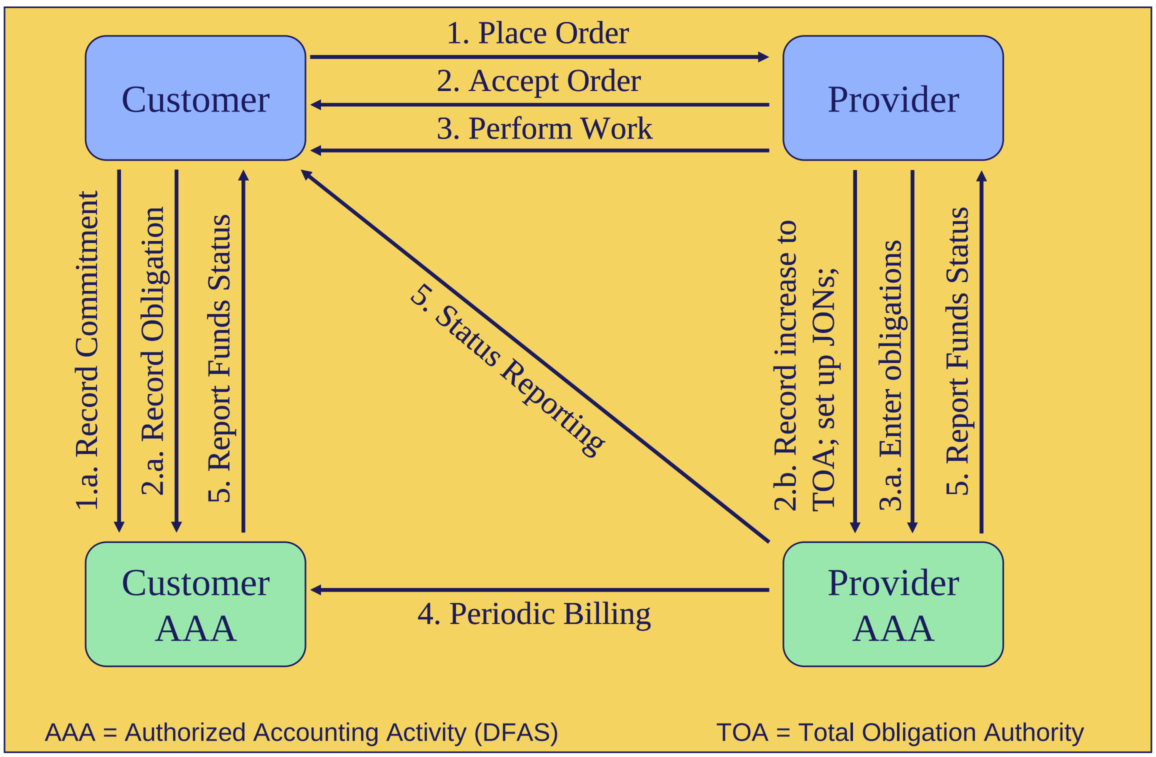

Figure 35 - Reimbursable Accounting Cycle

Chapter 9: Defense Working Capital Fund

Overview

Up to this point, the text has concentrated on two of the three ways a program or activity is financed: through direct appropriation or through reimbursable work orders. This section discusses the third way: revolving funds and specifically, the Defense Working Capital Fund. This section briefly covers the history of the Working Capital Fund (WCF), the relationships between the WCF and appropriated funded (APF) customers, the concept of unit cost, rates, rate setting, WCF budgets, budget review, and some insight on management issues inherent to the working capital fund.

A Brief History of Revolving Funds in DoD

Revolving funds have been used in the Navy since the late 1800's. The National Security Act Amendment of 1949 authorized the establishment of revolving funds within the DoD. A revolving fund is a fund in which all income is derived from its operations and is available to finance the fund's continuing operations without a fiscal year limitation. A revolving fund operates on a break-even basis over time; that is, it neither makes a profit nor incurs a loss. Simply stated, a revolving fund activity accepts an order from a customer, finances the costs of operation using its own "working capital," then bills the customer who reimburses the fund. The WCF typically does not get direct annual appropriations.

Prior to 1991, each component had its own stock fund and industrial fund. *Stock Funds* procure material (spare parts and other items) in volume from commercial sources and holds them in inventory to be sold to customers who need them to achieve weapon systems readiness or to provide personnel support. *Industrial Funds* provide industrial and commercial goods and services such as depot maintenance, transportation, and research and development. In 1991, all of DoD's stock and industrial funds were rolled into a single revolving fund, to form the Defense Business Operations Fund (DBOF), along with five additional defense commercial operations or business areas previously funded with direct appropriations. These included the Defense Finance and Accounting Service, the Defense Commissary Agency, the Defense Technical Information Center, the Defense Reutilization and Marketing Service, and the Defense Industrial Plant Equipment Center.

The Defense Business Operations Fund (DBOF)—the original fund established in 1991—was capitalized at a level significantly less than the sum of the stock and industrial funds it replaced. The consolidation of stock and industrial funds caused overall cash levels to be reduced by allowing funds or capital to be shared across all of the activities. This resulted in cash flow problems. The Defense Authorization Act addressed this issue, requiring that DoD conduct a comprehensive study of DBOF and present its findings along with a proposed improvement plan to Congress for approval. In December 1996, DBOF was reorganized into four working capital funds (Army, Navy, Air Force, and Defense-Wide). With the addition of a fifth fund—the Defense Commissary Agency in 1999—the new organization is officially called the Defense Working Capital Fund. The five funds and their corresponding business areas provide goods and services to DoD and authorized non-DoD activities.

With the advent of the working capital funds, the concept of providing total cost visibility remained. The responsibility for cash management and operating functions was levied upon the components to reinforce their roles in managing their respective activity groups. In the WCF, the Army, Navy, Air Force, USTRANSCOM and Defense Logistics Agency (DLA) centrally manage cash as opposed to USD(C). Cash balances must be maintained in a positive balance or a violation of the Antideficiency Act will occur.

Design and Objectives of the Defense Working Capital Funds[86]

The DWCF is a financial strategy that engages the use of competition in the free market and establishes clear customer/provider relations. The WCF adopts private sector techniques for resource management, consolidates various functions, and uses activity based accounting principles to display full costs. This gives management improved cost and performance data to make effective and efficient decisions and compete with other vendors for DoD assets. The DWCF builds upon the principles embodied in the free-market system to facilitate better business practices and budget decisions. Advantages of using the DWCF include:

- Identifies the total or "true" cost of DoD goods and services to Congress, military users (buyers), and those who provide goods and services (sellers), and thereby promotes more efficient and effective allocation and utilization of resources
- Underlines the cost consequences of certain choices and allows purchases to be made in anticipation of future funded orders
- Provides managers with the financial authority and flexibility to procure and use labor, materials, and other resources more effectively
- Improves cost estimates and cost control through comparison of estimates and actual costs
- Places customers in the position of critically evaluating purchase prices and the quality of goods and services ordered
- Allows for greater flexibility and security in decision-making, as there are no fiscal year limitations
- Establishes standard prices or stabilized rates and unit prices for goods and services furnished by DWCF business areas, enabling customers to plan and budget more confidently

[86] This section is taken from T. J. Moreau, “The Evaluation Of Appropriateness Of OMB Circular A-76 Studies On Revenue-Generating Functions In Defense Working Capital Fund Activities” Masters Thesis, Naval Postgraduate School, December 2002. and from OSD(C) iCenter website (no longer available)

DWCF differs from private-sector revolving funds in a number of ways, the primary one of which is in the area of incentives. While profit is the incentive in the private sector, breaking even is the motivating force in working capital funds. Each WCF has the goal of achieving a net operating result (NOR) of zero each year, which means that the activity generates enough cost recovery (revenue) from customers to match the costs it has incurred to provide the goods or services to its' customers.

The DWCF conserves resources by exposing costs that were previously not reflected in goods and services provided. Now that the provider has increased the cost visibility of their products, the customer can compare options on a fully informed basis and decide if they want to use the WCF provider. This exemplifies the foundation of the private market, a system that allows the consumer to choose the provider they desire at the price they can afford. If the price is too high or if the quality of work is not sufficient, the customer can search out another supplier. It is the foundation of supply and demand and a reflection of the competitive commercial market at work. The DWCF looks to add value through the integration of better business practices. Here are a few examples:

- Provides for total cost visibility and improved cost awareness
- Enables full cost recovery (capital costs can't be exceeded and money is saved for additional programming)
- Stabilizes rates to protect customers from inflation during execution
- Gives managers more flexibility by knowing the true cost of their decisions
- Shifts the focus from spending to cost and cash management
- Minimizes costs because customers determine what they need and can justify their decisions and funding allocation
- Measures performance and promotes greater taxpayer accountability
- Allows for greater flexibility and security in decision-making, as there are no fiscal year limitations

To be included in the DWCF financial structure, a proposed business area must meet four criteria:

(1) Outputs (i.e., goods produced and services provided) can be identified;
(2) An approved accounting system is available;
(3) Organizations (i.e., customers) that require and order products or services have been identified; and
(4) Advantages and disadvantages of establishing a buyer/seller relationship have been evaluated.

A chartering process is used to formally establish DWCF business areas and to identify their organizational structure, as well as their assets and liabilities. The DWCF Charter does not provide budgetary resources or authorizations to incur costs for the purchase of goods and services. Components can propose the establishment of new business areas to the Office of the Under Secretary of Defense (Comptroller) by preparing supplemental provision documentation. DoD components are required to review their DWCF operations each fiscal year to ensure that the supplemental provisions are current. Any changes are submitted as a charter amendment request to the OUSD (C). Existing charters are cancelled or amended upon approval by the OUSD (C).

The cost accounting system is necessary in order to allocate all costs associated with the activity across all the products and services sold. Recall, the objective of the WCF is full cost recovery (no gain or loss for a given year.) The WCF received its initial 'working capital" through an appropriation and/or a transfer of resources from existing appropriations, and uses those resources to finance the cost of operations. The initial appropriation, or lump-sum transfer of cash, is called a corpus. Generally, the WCF does not receive annual appropriations for its operations but finances its activities through the receipt and acceptance of customer orders.

Structure of the Working Capital Funds

The Defense Working Capital Funds consist of activity groups managed by the DoD components. Budgets, operating results, and overall management roll up to the activity group level. Some of the activity groups are unique to each service while the others may cross all or several services and the defense agencies. Figure 36 - Defense Working Capital Fund Business Areas displays the business areas, their functions, and their primary customers.

Business Area	Function	Customers
Base Support	Provides utilities services, facility maintenance, transportation support, engineering services, and shore facilities planning	DoD activities
Building Maintenance (BMF)	Finances operation, maintenance, protection, and repair of government-owned and leased facilities (exclusive of Pentagon Reservation)	All services
Commissary	Operates stores for resale of groceries and household supplies.	Members of the DoD military services and their families
Defense Reutilization and Marketing Service	Manages excess property within the government; disposes of hazardous property	DoD, Federal agencies, the public
Depot Maintenance	Repairs, overhauls, rebuilds, manufacturers, converts, inspects, and	Army, Navy, Air Force, Marines

Business Area	Function	Customers
	tests materials and vehicles	
Distribution Depots (DDC)	Provides worldwide warehousing for the DoD.	Inventory Control Points within military services and the operating units receiving materials
Financial Operations (DFAS)	Maintains payroll of all military personnel and responsible for all accounting operations.	All DoD services, including vendors, contractors, military personnel and their families
Information Services (DISA)	Provides information processing, software support, communications, technical support, and acquisition services.	Army, Navy, Air Force, Defense agencies, Office of the Secretary of Defense, other Federal agencies
Logistics (DLA)	Operates Supply Management, Distribution Depot, Reutilization and Marketing, and Document Services	DoD Components and other government agencies
National Stockpile Center (DNSC)	Provides safe, secure, and environmentally sound stewardship for materials in the National Defense Stockpile	All services
Ordnance	Manufactures and demilitarizes ammunition and artillery for all DoD branches, stores and issues ammunition, performs maintenance, and manages logistics of ordnance	All Services and Foreign Military Sales (FMS) for US allies
Pentagon Reservation (PRMRF)	Finances activities of Washington Headquarters Services (WHS) in providing space and building services for DoD Components within the Pentagon Reservation	Pentagon tenants
Printing Services (DAPS)	Provides printing and publication products and services.	DoD activities
Research & Development	Provides research, development, test, evaluation and engineering support.	Army, Navy, Air Force, and Office of the Secretary of Defense
Security (DSS)	Conducts personnel security investigations, provides industrial security products and services, provides security training	DoD agencies and other government entities
Supply Management	Manages inventories of fuels, weapon systems consumable, and depot level reparable spare parts.	Army, Navy, Air Force, other DoD agencies
Transportation	Provides airlift and sealift services for personnel and cargo; provides traffic	All services, Defense Logistics Agency, Joint

Business Area	Function	Customers
	management, land transportation, ocean terminals, and intermodal container management.	Chiefs of Staff, Special Operations Command, National Security Agency, other DoD agencies

Figure 36 - Defense Working Capital Fund Business Areas[87]

Understanding Cost

The OSD iCenter website states that the DWCF adds value because it "identifies the total or "true" cost of DoD goods and services to Congress, military users (buyers), and those who provide goods and services (sellers), and thereby promotes more efficient and effective allocation and utilization of resources." Just how does it identify those costs? This section explores the nature of costs, how we apply cost accounting principles to the DWCF activity and how those influence budgeting and rate setting.

Cost Elements

In order to calculate and allocate costs among products and services, an understanding of the nature of the costs is necessary.

- ***Direct costs*** are directly attributable to the end product or output. An example would be the direct labor hours associate with and repair parts consumed in the overhaul of an aircraft engine. Direct costs are allocated over specific output units.

- ***Indirect costs*** are costs that can't be directly tied to the output and are normally allocated over a select number of outputs. Some examples include indirect labor and indirect materials. A supervisor who has responsibility over employees who contribute to multiple product lines (or customers) is an indirect labor cost. Indirect material is a part of the end product or consumed in producing it, but is not economical to account for on an individual basis, such as lubricating oil or small fasteners purchased in bulk quantities. Indirect costs are often referred to as production overhead costs. They are allocated on a percentage basis across groups of outputs.

- ***General and Administrative (G&A)*** costs are costs that do not contribute directly to a specific product or output, but to the overall operation. These costs are overhead costs, as well, and remain relatively constant. Some examples include security costs, custodial costs, and salaries of staff

[87] From OSD(C) iCenter website, (no longer available)

personnel (comptroller, purchasing, etc.). These costs are allocated across all output units.

It is important to understand the behavior of these costs. Some costs are *variable*; that is, they increase or decrease in relation to the amount of work being performed. Direct material and most direct labor is in this category. Other costs are *fixed* or, at least in the short term (a given fiscal year), behave as if fixed. Most infrastructure costs, most G&A and most labor are in this category. Of note is that over the long run, all costs should be considered variable. In the short run, it may cost more to dispose of a fixed cost (e.g., move from one building to another or divest a portion of the activity), but those are things that should be considered when planning and budgeting for future years.

Unit Cost Concept

Working Capital Funds operate on the basis the concept of unit cost. Simply put, unit cost is total costs divided by some measurement of output, i.e., cost per direct labor hour, cost per dollar of sales, or cost per unit shipped. The total costs divided by the total output equals the average unit cost, or average cost per unit.

The elements of cost are in the numerator while the output is in the denominator. Clearly, the performing or supplying activity has control over the numerator (costs) while the customers determine the denominator (output, or demand). Because both costs and output (demand) can vary, managing a WCF activity requires attention to both internal cost control and the scope of the customer base. The latter part of this chapter will explore management issues associated with cost and revenue control.

To determine a unit cost, the *output* must be identified. It must be measurable and able to be separated from other outputs so costs may be allocated across those outputs. Outputs can be a product (e.g., an overhauled engine, a repaired pump, or this textbook) or a service (e.g., research reports, software engineering, accounting functions, or information systems hosting). Normally, the output for a product is the product itself. Often services are reflected in an output measure such as a direct labor hour or billable workyear. Other services are priced based upon usage (e.g., CPU time, forms processed, or passengers transported).

Without going into the details of cost accounting (which would be a textbook in and of itself), the DWCF activity must decide for each unit of output, how the direct, indirect, and G&A cost must be allocated. These are critical decisions since the activity budget and rates are based on this allocation. Poor allocation techniques will distort the true cost of producing an output and the DWCF activity may find itself marketing unprofitable products when it should be repricing them instead. Those students deeply involved in this process are encouraged to take a class in cost accounting.

Unit Cost Goal

Where unit cost is the total cost of producing a good or service divided by the numbers of those outputs, it is a backward-looking metric. It is recorded history. For planning purposes, the unit cost goal (UCG) is used. The UCG is the estimated total cost to produce an estimated number of outputs. These UCG planning estimates serve as the basis for the WCF budget, the rate charged to the customer, and for evaluating the activity's performance.

UCGs are issued in the Annual Operating Budget (AOB) and are to be used to manage the activity by comparing actual costs with the established target. Similar to how a budget analyst or comptroller compares their actual obligations and expenditures to their budget authority, the WCF manager or analyst compares the actual unit cost to the UCG. The UCG is the measuring stick for performance during the execution phase.

The estimated level of workload drives the unit cost goal. The UCG is the *maximum allowable cost* that can be incurred to produce that level of work; it is a target or goal. The UCG is computed at the product and activity level, but rolls up to the activity group level into a composite rate for the group. It is the activity group that must achieve its target and those responsible for the management of the activity group may permit one activity within that group to exceed a target if other activities within the group are sufficiently below target to ensure the group as a whole balances.

It was stated above that the UCG is used to manage the activity. It is actually used in two ways. First, it is the basis or starting point for rate setting. Second, it is used as a benchmark to track actual costs against. The rate setting process will be explored first. Rate setting differs between the supply management activities (goods) and the non-supply management activities (usually services.)

Rate Setting[88]

DWCF rates/prices are established through the budget process and remain fixed during the year of execution. These rates charged to customers are developed and proposed by the Components in their Budget Estimate Submissions (BES) and, once approved, remain fixed during the year of execution. Rates are required to be established at levels estimated to recover the cost of products or services to be provided by a business area, as well as approved cost recovery elements. Final approved rate changes are established by OUSD (C) and recorded in Program Budget Decision (PBD) documents.

The budget process is also the mechanism used to ensure that adequate resources are budgeted in the customer's appropriated fund accounts to pay the established rates. Once established, rates are stabilized (held constant) for the

[88] This section is taken from Defense Working Capital Fund Handbook, available at OSD(C) iCenter website: http://www.dod.mil/comptroller/icenter/dwcf/dhchap3.doc

applicable fiscal year. This “stabilized rate” policy serves to protect appropriated fund customers from unforeseen cost changes and thereby enables customers to more accurately plan and budget for DWCF support requirements. In turn, this policy also reduces disruptive fluctuations in planned DWCF workload levels, permitting more effective utilization of DWCF resources.

Using guidance from OSD and the respective Component, managers of DWCF business areas are required to set their rates and prices to recover all operating and capital costs associated with the products or services to be provided. Rates and prices for the budget year will be set to recover the cost of products or services to be provided. This means that rates/prices will be set to achieve an Accumulated Operating Result (AOR) in the budget year of zero. During budget execution, business areas will record either a positive or negative Net Operating Result (NOR). Accordingly, rates/prices in the budget year will be set to either make up actual or projected losses or to return actual or projected gains in the budget year(s).

Gains or losses in operations may occur as a result of variations in program execution. *Realized gains or losses* are generally reflected in offsetting adjustments to stabilized rates established in subsequent fiscal years.

Customer rates are established on an end product basis whenever feasible. The term “end product” means the item or service requested by the customer (output) rather than processes or other inputs used in the achievement of the requested output (for example, the product requested rather than the direct labor hours expended in the achievement of that products).

The DWCF includes a variety of business areas that are categorized into two groups for rate setting purposes:

- The **Supply Management Business Area** uses commodity costs in conjunction with a cost recovery factor to establish customer rates (or standard prices). Individual item prices will be established by including the cost recovery elements, by percentage or fixed amount, with the commodity acquisition cost of the item.

    - The commodity cost (or acquisition cost) is the most current cost of a representative procurement.
    - The cost recovery factor is developed based on cost recovery consisting of elements for: operating costs plus prior year gains/losses; shipping and transportation; inventory expenses; economic adjustments for inflation; and repair costs including attrition.

- The **Non-Supply Management Business Areas** (Depot Maintenance, Research, and Development, Distribution Depots, etc.) use unit cost rates established based on identified input/output measures. These measures establish fully cost burdened rates, such as cost per direct labor hour, cost per product, cost per item received, cost per item shipped, etc. These two areas will be examined in more detail.

Rate Formulation for the Supply Management Activity Group

The Supply Management activity group rate setting process is complex due to inventory valuation procedures, and the use of standard and net prices. For simplicity, we will not be concerned with pricing policies or inventory valuation methods.

The surcharge (or cost recovery) amount is computed on the SM-5a exhibit.

- First, **sales** are estimated at the latest acquisition cost (LAC) or the latest repair cost (LRC). "Sales" in this terminology means the estimated dollar *value of items* issued from inventory, or "cost of the goods sold" to customers.
- Next, the cost recovery factor elements **(surcharge elements)** are estimated. These include the *cost of supply operations* (payroll, utilities, maintenance, etc.), *capital depreciation expense, material inflation adjustments, material loss* (e.g., depot washout) and *obsolescence costs, transportation costs*, the *AOR recovery amount* and any directed *adjustments* required by DoN or DoD (e.g., those mandated in a PBD). These costs are totaled and allocated across the cost of sales as the "surcharge" amount.

Finally, the SM-5b exhibit is prepared, which shows the customer price change. The surcharge amount from the SM-5a exhibit is divided by the total amount of sales adjusted for inflation. The numerator contains the costs to operate the activity group (driven by the provider) and the denominator contains the estimated dollar value of goods that will be sold (driven by the customer). In other words, the total costs for operations are divided by the estimated dollars of sales, yielding the "cost per dollar of sales."

The cost recovery factor is in the form of a percentage. Say it is 26%…. the customer will pay 126% of the cost of the item. For example, if a customer requisitions an item that costs $100 he will pay $126 ($100 item cost plus the 26% cost recovery factor). If a customer requisitions an item that costs $100,000 he will pay $126,000. By applying the cost recovery factor to the cost of the items, the activity group recovers its costs of operations.

Rate Formulation for the Non-Supply Management Activity Group

The following is an overview of the rate formulation process for the Non-Supply Management Activity Group. The example of an aviation depot will be used for this overview. First, the total number of direct labor hours (DLH) to accomplish a given task or output is established. The number of DLHs required per aircraft (the labor hours required for each job are normally from a “fixed price catalog” at each depot) times the number of aircraft the Navy expects to overhaul equals the projected customer requirement. Prior year orders that are expected to be completed are subtracted from the total, as those were funded in prior years.

Next, the total costs are estimated. These costs include all direct, indirect and G&A costs, and comprise the Cost of Goods Sold (CoGS). The CoGS estimate is divided by the total DLHs and yields an initial rate.

The component then adjusts the initial rate for prior year losses or gains. If there is an accumulated operating loss, then the adjustment is an *increase* to the customer cost. (Since, theoretically, they have been underpaying in the past.) If there were an accumulated operating profit, then the adjustment would result in a *decrease* to the program cost. (Since, theoretically, they have been overpaying in the past.) Of note is that prior year losses and gains may be recouped over a two-year period, with no more than 50% of the recovery in the second year.

The adjusted CoGS is then divided by the total DLHs which results in the rate to be charged. This rate is compared to the prior year’s rate and is promulgated as a percentage change, which is applied to the customer accounts. These percentage changes are published in Program Budget Decision (PBD) 426 every year.

Since individual DWCF activities are part of activity groups and the DWCF is managed at the activity group level, there may be further adjustments to the rates. Take, for example, aviation depots where it is sometimes the case that one activity is particularly profitable versus another. If one depot maintains a type of aircraft that is growing in numbers (F/A-18C/Ds, for example) and another depot maintains aircraft that are decreasing in numbers (S-3s), the first depot has a larger business base across which fixed costs can be allocated. This lowers the rate or raises the profitability of that depot. Conversely, the second depot will experience rising rates or will experience losses. Since the total cost to the aviation depot activity group is the same, the activity group manager could choose to have the first depot subsidize the second depot and have them adjust their rates, accordingly. This would not be done in the long run, but could be done on an ad hoc basis. Other rate adjustments could result from budget Issue papers and PBDs issued at the service or DoD level.

In short, rates are based on the unit cost goal, adjusted to account for the accumulated operating result (AOR) and adjusted further (as applicable) by activity group or agency comptroller directive. Recall in the beginning of the chapter, it was mentioned that the UCG is only the BASIS for setting the rate. It’s only the starting point for setting the rate and then it is followed by these potential adjustments that result in the actual rate paid by the customers, known as the stabilized rate.

There is one more exception. Depots (Navy and Air Force only) do not fall under the annual stabilized rate tenet of other working capital fund business units. Unbudgeted losses or gains of $10 million or more will be recouped or returned in the *current* fiscal year. This change came about in fiscal year 1998 when OSD decided to recover depot losses in the year in which they occur. This decision was promulgated in PBD 437 and Congress later codified this into law. While this policy may help control operating losses in the activity groups, it could cause execution problems for customers. However, since the components are responsible for the management of their working capital funds, they have the incentive to not invoke rate changes during the year of execution --- any resource adjustments would have to be "taken out of hide."

Budgeting

Recall one of the tenets of the WCF: the customer – provider relationship. Customers discuss their projected workload with providers, and the providers project estimated rates based on the projected workload. Budget formulation in the DWCF begins approximately two years in advance, in concert with the appropriated fund budget formulation process. Because the WCF budgets are based on estimated costs and estimated workloads, estimated almost two years in advance, not all data will be accurate. Priorities change, leadership changes, missions change, commands shut down, move, or consolidate over time. In addition, because the WCF activity groups are managed at the component level, each activity group's projected revenues and expenses are examined in their entirety --- it is not simply a matter of establishing budgets for each individual activity within each activity group. Therefore, the budgets (both the appropriated fund accounts and the WCF budgets) are adjusted up the chain of command, from the component level and finally at the OSD level. We will review this process shortly.

Budgeting for DWCF activities has two parts. First, there is an **operating budget** that includes all direct, indirect, and general & administrative costs, including expenses for depreciation of assets. Costs include labor, nonlabor, materials, supplies, utilities, real property maintenance, personnel and payroll support. The operating budget also includes the output estimates based upon information from customer budget plans. Second, there is a **capital budget** that includes funding of investment items for industrial equipment, construction, telecommunications equipment, IT infrastructure, and software. The capital investments are budgeted separately, capitalized, and depreciated in the operating budget. This process allocates the cost of investments across their useful life. Each budget will be examined in turn.

Operating Budget Formulation

All costs are aggregated from the bottom up, at each cost center or department. The operating budget represents the annual operating costs of civilian and military labor, depreciation expense (except for major Military Construction), materials, supplies, utilities, real property maintenance, payroll support, contracts and equipment purchases less than $100,000 (the current capitalization threshold). Military personnel costs are priced at a civilian equivalency rate published by USD(C), and the Military Personnel appropriation is eventually reimbursed by the WCF.

Important budget exhibits used include the Fund-1A: Detail of Price, Program and Other Changes; Fund-4: Summary of General and Administrative Costs; Fund-5: Total Costs per Output Summary; Fund-11: Sources of Revenue; and, Fund-14: Revenue and Expenses.

The Fund-1A exhibit corresponds to the OP-32 Summary of Price and Program Growth exhibit for the Operations and Maintenance appropriation, and is used to match WCF budgets to customer accounts.[89]

Capital Budget Formulation

The capital budget is used to budget for capital investments and improvements (i.e., purchases of $250,000 or more) having a useful life of 2 years or greater. Capital investments are grouped into four categories: ADP and telecommunications equipment, non-ADP equipment, software development, and **minor construction** projects from *$100,000 to less than $750,000*. Components may reprogram capital funds between activity groups up to $10 million for each of the four investment categories approved in the President's Budget (PB).

Students should recognize that there is a difference between capitalization for budgeting purposes and capitalization for accounting purposes. The two are not the same. For budgeting purposes and deciding between expense or investment funds, the threshold is $250,000, except for minor construction (still $100,000 threshold). For accounting purposes and classifying assets on the financial statements, the threshold remains $100,000 for all assets except in the working capital fund. In April 2007, OSD(C) raised the accounting threshold from $100, 000 to $250,000 in the working capital fund only. All other assets continue to use the $100,000 capitalization threshold for accounting purposes. Assets that meet the accounting threshold but do not meet the budget expense/investment threshold will be treated as a capital asset and depreciated of the useful life of the asset.[90]

[89] Defense Working Capital Funds Basic Course, DFAS, October 1997

[90] DoD Financial Management Regulation, Volume. 2B, Chapter 9, paragraph 090103.C.1. and C.8.

Prior to budgeting for capital investments, an economic analysis must be conducted for projects $1,000,000 and greater and account for workload, costs, alternatives and benefits derived from such investments. If the cost is less than $1,000,000 a cost analysis must be conducted. Additionally, a post-investment analysis is required for recurring-type investment projects of $1,000,000 or greater.

Budget exhibits used for the capital budget include the Fund 9-A (Capital Investment Summary), Fund 9B (Capital Investment Justification) and Fund-9C (Capital Investment and Financing Summary).

Capital assets will be depreciated on a *straight-line* basis unless approval has been obtained to use an alternative method. The *depreciation expense* will be included in the operating budget, charged as a cost element in the customers' rates. The depreciation schedule follows (for acquisitions after 1 October 1999):

- ADP and telecommunications equipment: 5 years
- Commercial software: 5 years
- Internally developed software: 10 years
- Printing and duplicating equipment: 10 years
- Equipment & machinery other than ADP or telecommunications: 12 years
- Improvements to land (fences, bridges, etc.): 20 years
- Buildings, hangars and other real property structures: 40 years

Military construction costs (i.e., costs of $750,000 or greater) will be funded by *direct appropriation*. Other costs funded by direct appropriation include general-purpose passenger vehicles, mobilization costs, war reserve material, and unutilized and underutilized plant capacity costs.

Annual Operating Budget (AOB) and Cost Authority

As previously stated, the approved unit cost goal is provided to the components through the Annual Operating Budget (AOB). The AOB is issued to the components, down to the activity group managers (e.g., DLA for distribution depots, NAVSUP for inventory control points, NAVAIR for aviation depots, etc.)

The initial AOB is normally issued just prior to the beginning of the fiscal year after USD(C) obtains apportionment authority from OMB. Modified AOBs are often issued throughout the year of execution to reflect changes in cost and cost authority. Remember, if rates can't change; only the budget estimate can.

The late issuance of the AOBs is derived from 10 U.S. Code section 2208, which postpones the release of the budgets beyond the appropriation of funds. That way, costs can be changed and customer accounts can be adjusted. As a side note, the *rates* (prices charged to customers) issued in PBD 426 are normally published in the late December or early January timeframe, approximately 10 months prior to execution.

The AOB provides the output measure, the unit cost goal and desired Net Operating Result (NOR). (The NOR is the desired operating result, reflecting revenues based on the composite rate minus the approved costs for one fiscal year.) T*he total cost on the AOB represents the maximum amount of* ***costs*** *that can be incurred.* In addition to the UCG and total cost, capital budget authority is delineated on the AOB. The unit cost goal and total costs can be changed with approval from USD(C), assuming there is an increase in workload. This change would provide additional authority to incur cost.

Budget Review

Upon compilation of the activities' budgets within the activity groups by the activity group manager (e.g., DLA, NAVAIR, etc.), they are forwarded to the component FM. Each component reviews the proposed rate structures and all projected costs (based on workload), including new work or any work carried over from prior fiscal years.

The components will review the costs and adjust the proposed rates to account for inflation, pay raises, prior year losses or gains, and any PBDs or other directives affecting operations. The components try to balance the appropriated fund budget and working capital fund budget. Finally, the proposed rates and costs are then forwarded to USD(C) as part of the annual BES submission.

USD(C) will review each component's costs and proposed rates, making adjustments to bring the AOR for each activity group to zero. These *composite rates* are published in PBD 426 in the late December or early January timeframe. *PBD 426 accounts for final costs and program levels at the DoD level, and also makes adjustments to the customers' appropriated fund accounts.*

Although a composite rate is published, components are authorized to develop and use *subsidiary rates* as long as those rates can be "rolled up" into the activity group's composite rate. For example, depot maintenance composite rates can be broken down into different rates based on the type of ship or aircraft being repaired. Not all direct labor hour costs are the same.

You may wonder why OSD has the final approval on WCF budgets although each component is now responsible for its own working capital fund and cash management. The SECDEF is required to submit to the President a budget per

10 U.S. Code Section 221 and is therefore responsible for the *entire DoD budget*, of which the WCF is a large part (approximately 25%). Lastly, this process maintains balance between the appropriated accounts (customers) and the working capital fund (providers).

To summarize, the DWCF activity budgets and sets rates based upon an allocation of all costs required to deliver a set of outputs estimated by potential customers. This cost calculation forms the basis for the rates charged to those customers with the objective of attaining a neutral (zero) accumulated operating result by the end of the budget year. The next section examines the management of the DWCF activity during execution when both projected costs and customer orders differ from estimates, yet the objective remains the same.

Working Capital Fund Management

All DWCF activities operate to break even over the long term and budget to an Accumulated Operating Result (AOR) of zero. The AOR is the net sum of the annual Net Operating Results (NOR), where NOR equals the annual revenue minus the annual costs. WCF activities charge annual, stabilized rates based on estimates of costs and projected customer orders. In addition to this long-term goal, activities are to maintain 7 to 10 days worth of operating cash and 4 to 6 months of capital outlays. Solvency must be maintained locally, and overall cash management is performed at the component level. WCFs are still subject to the Antideficiency Act and must not exceed available budget authority.

Between the time the budget is submitted and the year of execution, there have been fact-of-life changes to both the DWCF activity and its customers. Pay raises have been provided, workers have come and gone, the mix of customer orders has changed, there have been technological improvements, authorizing legislation may have changed policy, and fleet operations may have affected the quantity and quality of the demand for goods and services. So there are changes to both the numerator effect (costs) and the denominator effect (sales). DWCF activity management must stay actively engaged in both arenas.

Execution and Performance: Changes in Workload and Cost

An example is a helpful way to illustrate the management issues and responses. For the purpose of simplicity, assume this activity began operations this year, no carry-over of prior year work exists, and it has not incurred any prior year losses or gains.

1. Workload is estimated to be 208,000 hours and costs estimated to be $11,440,000. Based on its workload estimate and resultant cost estimate, it will be issued a unit cost goal of $55 via the AOB. The AOB gives a not-to-exceed amount and is the target for management; they are to cover their expenses with revenues (Revenues – Expenses = Net Operating Result). Since there is no AOR adjustment, in this simple example the unit cost goal will equal its rate.

Year 1 in Operation	
Estimated workload (DLH) from customers	208,000
Estimated costs based on workload	$11,440,000
Unit cost goal per AOB	$55
Rate for year 1 (no NOR or AOR)	$55

2. Advancing to the end of the first quarter, one would expect 25% of the labor hours to be expended and 25% of the costs to be expended. However, that is not always the case. Assume 52,000 hours of output at an actual cost of $3,068,000. The average unit cost exceeds the goal and the NOR at this time is a $208,000 loss.

Quarter 1 (25% of time)	
Actual workload (output) in hours	52,000
Actual costs to date	$3,068,000
Average unit cost	$59
Revenue (output x rate charged)	$2,860,000
NOR to date (Revenue – expenses)	-$208,000

   Management would look into the nature of higher costs. Perhaps the work takes a long time and there are high up-front costs and lower costs in the latter stages of the work…this would be acceptable. Customer orders seem to be on target (52,000 hours is 25% of 208,000), but costs are higher.

3. Advancing to the end of the second quarter, 50% into the fiscal year. The numbers provided below are cumulative.

Quarter 2 (50% of time) – cumulative	
Actual workload in hours	114,400
Actual costs to date	$6,520,800
Average unit cost	$57
Revenue (output x rate charged)	$6,292,000
NOR to date	$-228,800

The situation has improved. Workload has increased and is at 55% of the total estimated labor hours, while costs are at 57%. The average unit cost has dropped by $2 per DLH, the NOR is still negative but its rate of growth has declined. Management should look at two variables: the increased orders (if this rate continues through the rest of the year, do we have sufficient resources to fill the demand?), and the higher costs (per unit costs are falling, but remain higher than the UCG, why?).

4. The example advances to the end of the fiscal year.

Quarter 4 (100% of time) - cumulative	
Actual workload in hours	197,600
Actual costs to date	$11,400,000
Average unit cost (actual) per DLH	$57.69
Revenue (output x rate charged)	$10,868,000
NOR for Year 1 in operation	-$532,000

The activity incurred a loss in its first year of operations. Despite running ahead on orders in the first half, those orders slowed in the second half and the actual output was less than projected. Cost, however, was higher than projected for this level of output, resulting in a negative operating result. Overall costs did not exceed the goal established in the budget so that is not a concern.

What happened? The activity "sells" direct labor…perhaps it is an R&D center or a central design activity (IT support, software development) and bills based on direct labor hours. Not all of the billable hours were billed to customers, but the employees needed to be paid, regardless. By not having a reimbursable order against which to charge their time (and receive the allocated portions of indirect and G& A costs) the activity spent the same amount of money, but did not recover it fully. Either customer demand dropped or the workers were more efficient and completed the work in less time than projected. While the latter is good and needs to factor into future estimates, the business result is that not all costs were recovered. If the employees were more productive, management should have solicited additional orders for the employees to bill their time against.

Now the negative NOR of $532,000 will be factored into the rate setting process for the following year. Actually, we budget two years ahead so there is a lag time involved. Again, for simplicity, assume instantaneous budgeting and rate setting; also assume the loss will be recovered in one year instead of two years.

After consulting with customers, they propose a workload estimate of 200,000 hours. This is 8,000 hours less than last year… Based on the workload estimate and our experience from the last cycle, we estimate our costs to be $11,600,000 or $58 per DLH. But unlike last year, there is an AOR that needs to be addressed.

Estimated workload (in hours)	200,000
Estimated costs based on workload	$11,600,000
Unit cost goal per AOB	$58
ADD in -$532,000 NOR to estimated costs for rate determination. Revised cost of goods sold.	$12,132,000
Divide revised CoGS by estimated workload (output) for rate. This is the customer rate charged per DLH.	$60.66
NOR to achieve AOR of zero	+$532,000

In the AOB the activity is issued a unit cost goal of $58 per DLH and is not to exceed $11,600,000 in costs. Also, since the activity lost $532,000 last year, it must be recovered by adding that amount to the $11,600,000 for a total cost basis of $12,132,000. The total cost divided by the estimated workload yields a rate of $60.66 per hour. If they bill all 200,000 hours at that rate, they cover all the costs and recover the prior year loss. In other words, they budget for an NOR of +$532,000 to drive the AOR to zero.

Recall that they charged $55 per DLH last year. When they advertise to their customers the rate is now $60.66, there may be a reaction in the form of lower demand (due to the higher cost). Management must be sensitive to what economists refer to as the "elasticity of demand" – as prices go up, demand drops off, but the rate at which it drops off varies by customer and product.

The example will progress to the end of the second year with slightly different results from the first year. Assume that workload projections exceed expectations.

Actual execution results – subsequent year	
Actual workload (output) in hours	205,000
Actual costs to date	$11,850,000
Average unit cost	$57.80
Revenue (output x rate charged)	$12,435,300
NOR (revenues minus expenses)	$585,300
AOR (NOR + NOR, or total revenues – total expenses)	+$53,300

The actual unit cost per DLH was slightly lower than the unit cost goal. This is probably to be expected. Since they sold 5000 more direct labor hours than projected, they recovered 2.5% more indirect and G&A costs. How? All of the indirect and G&A was allocated across the first 200,000 hours. Selling 2.5% more hours means those costs have been recovered 102.5%. All of the work sold above the initial 200,000 hours need only recover the direct or marginal costs, but since we have stabilized rates, these additional sales will generate a profit. (Assuming our fixed and direct costs were exactly as budgeted.)

This increase in revenue exceeded the NOR of +$532,000 provided in the AOB; resulting in $53,300 of "profit." What happens next? The activity again discusses workload requirements with their customers and bases their costs on the measure of output. Then they will factor in the +$53,300 gain by subtracting it from the total costs, resulting in lower customer rates (for the same level of demand).

One can see that the management challenge is to ensure they sell all that they set out to sell (in this case, all of the billable employees are engaged in billable work), but not too much more. They also need to focus on costs to ensure that they remain within projections. Should an activity sell less output, managers may market the activity to make up the deficit, cut costs or some combination of both. If the activity sells more output, managers have the opportunity to spend more on necessary expenses like deferred facility maintenance or employee training, they may offset losses elsewhere in the activity group, or they may "rebate" the funds through lower rates in future years.

Execution and Performance: The "Surcharge"

Our attention now turns to the Supply Management business area and the unique dynamics of managing it. One of the primary management issues here is the perception of the cost recovery rate by the customers. Remember, the cost recovery rate is the surcharge applied to the cost of the material to recover the costs of running the supply infrastructure (warehousing, transportation, purchasing, inventory management, etc.). The customer wants that number to be as low as possible, but the more effective leverage point to save the Navy money is the cost of the material, not the surcharge. To illustrate:

Cost of Operations = $490M
Cost of Good Sold = $3,150M
Total Cost to the Navy = $3,640M
Cost Recovery Rate = 490/3150 = 15.6%

Assume the Supply Management Activity Group management improved efficiency by 25% by trimming all the fat from the system, consolidating operations, outsourcing non-essential functions, etc. The new figures are:

Cost of Operations = $368M (25% less)
Cost of Good Sold = $3,150M
Total Cost to the Navy = $3,518M
Cost Recovery Rate = 368/3150 = 11.7%

The Cost Recovery Rate dropped from 15.6% to 11.7%…a great savings. This should please the customers. Now, assume that instead of cutting the inefficiency and passing the savings along in a lower recovery rate, the Activity Group management spent the same on cost of operations, but instead focused their efforts on negotiating better prices for the goods sold. These efforts result in a 6% savings in CoGS. The new figures are:

Cost of Operations = $490M
Cost of Good Sold = $2,961M (6% less)
Total Cost to the Navy = $3,451M
Cost Recovery Rate = 490/2961 = 16.6%

Now the Cost Recovery Rate has climbed from 15.6% to 16.6%…this should displease the customers. They are paying more, right? Not exactly. What the customers may not notice is that the *total cost* to acquire the same goods has dropped from $3,640M to $3,451M, a savings of $189M. These savings are more than one and a half times the savings of the measures that merely lowered the Cost Recovery Rate.

Chapter 10: Department of Defense Accounting

Overview

The DoD accounting system is controlled by acts of Congress; regulations of the Comptroller General; the General Accountability Office; the Office of Management and Budget; and the Department of the Treasury.[91] Congress delineates objectives for the DoD accounting systems, and core financial system requirements have been developed by the Financial Systems Integration Office (FSIO), formerly known as the Joint Financial Management Improvement Program (JFMIP) (see the FSIO web site at http://www.fsio.gov/fsio/fsiodata/fsio_about.shtml) Accounting systems are to provide timely and accurate information; provide for reliable reporting; support policy decisions and the formulation and execution of budgets; and, provide an audit trail.

Accounting is the process of capturing, classifying and reporting financial transactions for the benefit of stakeholders. Naval officers reading this might compare the accounting function with the function of the combat information center on a ship: to collect, interpret, analyze, and report tactical data so that it is useful to the CO and tactical action officer. Accounting does the same, only with financial data. DoD has many different funding methodologies such as appropriated funds, revolving funds, trust funds, and nonappropriated funds; therefore it requires accounting systems robust enough to handle those funding methodologies. DoD requires accounting systems that not only accurately record transactions and financial status, but also provide proper data for resource allocation decisions, and that ensure compliance with fiscal law. That's three different objectives, requiring three different types of accounting, each with their own techniques, audiences, objectives, outputs and vocabulary.

DoD accounts for appropriated funds through ***budgetary accounting*** which is designed to ensure compliance with the terms of the appropriation and the principles of fiscal law. Budgetary accounting is that which government employees are most familiar. It's the process of budgeting, defending, and accounting for appropriations. Terms associated with budgetary accounting include: commitment, expenditure, apportionment, obligation, authority, and disbursement. There are strict rules embedded in federal law and principles articulated by the Comptroller General. There is significant oversight. The focus is on compliance with the law - that funds have been spent in accordance with the purpose, time and amount restrictions attached to the appropriation. The audience is both internal and external. DoD does this type of accounting very well. It's the only type of accounting that has been widely practiced. The private sector is not as familiar with budgetary accounting. Try discussing the concept of

[91] Financial Management Guidebook for Commanding Officers, Department of the Navy NAVSO P-3582 pp V-1.

“obligation” with a Certified Public Accountant (CPA) or a college accounting professor and gauge their reaction.

DoD and other federal agencies are required under the Chief Financial Officer’s Act to perform ***financial accounting***. Financial accounting is what one sees in a corporation’s annual report: balance sheets, income statements, and statements of cash flow and owner’s equity. Terms associated with financial accounting include profit, earnings before interest and taxes, depreciation, and revenue recognition. It is done in accordance with Generally Accepted Accounting Principles to ensure comparability across entities and over time. The rules are rigid and strict; there is governmental oversight. The focus is on accurate and reliable capturing, recording, categorizing, and presenting historical events. The intended audience is outsiders: for a corporation, the outsiders are those in the capital markets (potential lenders and investors); for a government agency, the outsiders are those with a financial interest (legislators and taxpayers).

The third method is ***managerial, or cost, accounting*****.** Managerial accounting is what one doesn’t see in the annual report. It’s the internal analysis conducted by the corporation to weigh one decision against the next: should we expand this plant, should we drop this product line, should we buy or lease the capability, what does it cost to provide this service versus an alternative? Terms associated with managerial accounting include weighted average cost of capital (WACC), allocation, cost driver, internal rate of return (IRR), and profit center. There are common tools and practices, but no generally accepted management accounting principles; there is no government oversight, unless the corporation is working on a major government contract. The focus is on internal management decisions regarding the mission and scope of operations of the organization so management decides what to count and how to account for it. The audience is internal; in fact, the data is so proprietary corporations wouldn’t dream of sharing it. Within DoD, this type of accounting enables working capital fund activities to set their rates based on unit cost. It is also, arguably, the best data for making resource allocation decisions.

History of DoD Accounting

Prior to the 1990s, each service and other defense agencies had their own unique accounting and finance (payroll) systems. The systems were not integrated, even within the same service. Thousands of unique, tailor-made “feeder systems” were developed to satisfy user requirements and they often did not conform to generally accepted accounting principles.

The Defense Finance and Accounting Service (DFAS) was established on January 15, 1991, to reduce the cost and improve the overall quality of Department of Defense financial management through consolidation, standardization and integration of finance and accounting operations, procedures and systems. The Deputy Secretary of Defense issued Defense Management

Report Decision (DMRD) 910 in December 1991 on the consolidation of DoD finance and accounting operations. DMRD 910 directed the DFAS to:

- Assume the finance and accounting functions of the DoD components by October 1, 1992.
- Assume responsibility for all finance and accounting regionalization and consolidation efforts throughout DoD.
- Establish an implementation group, with senior representatives from DoD components to develop an implementation plan for submission to DoD Comptroller.

In December 1992, DFAS took over responsibility for 338 finance and accounting offices that belonged to the military services and defense agencies. Through consolidation efforts under BRAC, DFAS will consist of a headquarters and five centers located in Cleveland, OH; Columbus, OH; Indianapolis, IN; Limestone, ME, and Rome, NY. The five centers are former accounting and finance activities that are organized along service (component) lines. Efforts are now underway to reorganize DFAS' processes along product lines. Personnel have also been reduced from 31,000 in 1992 to the current level of 14,000. It's anticipated that DFAS will reduce personnel down to less than 10,000 by 2011. The 2009 projected DFAS organization is shown in Figure 37 - Projected DFAS Organizational Structure.

Cleveland
Accounts Payable (Vendor Pay)
Navy Field Accounting
Marine Corps Field Accounting
Navy/Marine Corps
Active & Reserve Pay
Disbursing
Civilian Pay
Corporate Organizations
Strategic Business Mgmt
Navy Departmental Reporting
Marine Corps (KC) Disbursing
Marine Corps TSO/MCTFS

Centers of Excellence Cleveland

Columbus
Accounts Payable (Vendor Pay)
Air Force Field Accounting
Defense Agencies Accounting
Disbursing
Corporate Organizations
Strategic Business Mgmt
Air Force Departmental Reporting
A.F. Acc't Production Control
DEAMS

Center of Excellence Columbus

Acquisition Accounting including Contract Pay

Indianapolis
Accounts Payable (Vendor Pay)
Army Field Accounting
Classified Accounting
Army Departmental Reporting (Only)
Disbursing
Army/Air Force Active & Reserve Pay
Trust Fund Accounting
Civilian Pay
Transportation Payments
Travel Pay
Corporate Organizations
Strategic Business Mgmt

Centers of Excellence Indianapolis

Security Assistance Accounting

Out of Service Debt

Limestone
Air Force Field Accounting
Accounts Payable (Vendor Pay)
Corporate Organizations

Center of Excellence Limestone

Transportation Working Capital Fund Accounting

Rome
Army Field Accounting
Accounts Payable (Vendor Pay)
Corporate Organizations
Classified Accounting

Centers of Excellence Rome

Medical Accounting

Special Ops Accounting

Figure 37 - Projected DFAS Organizational Structure

DFAS further assumed responsibility for 324 disparate finance and accounting systems that used non-standard procedures and practices, and were not compliant with federal accounting and financial management requirements. They were initially developed based on each component's unique interpretations of high-level financial management policies which varied among the components, operated on different architectures and employed various degrees of financial management or business area integration. Additionally, thousands of activities use different "feeder systems", varying from automated applications, to spreadsheets, to manual (paper) input. DFAS has consolidated and standardized finance and accounting systems from those 324 in fiscal year 1991 to 65 in fiscal year 2004, with further consolidation planned. In addition, DFAS is at the heart of the DoD's Business Management Modernization Program (BMMP). The scope of BMMP is broad and deep, encompassing the Department's business activities and infrastructure. The Department's business activities include financial and non-financial operations and systems. Non-financial business operations and systems include those that support the acquisition, medical, transportation, property, inventory, supply, and personnel communities, as well as other communities. The first step is to design a Business Enterprise Architecture (BEA) that will modernize and integrate both processes and systems, which are now isolated from one another. The BEA will be the blueprint to transform the Department's business operations and will leverage systems and technologies to enable this comprehensive change.[92]

To get a feel for the volume of activity that DFAS does, here's the summary of their FY06 productivity[93]:

- Paid 145.3 million pay transactions (5.9 million people)
- Made 7 million travel payments
- Paid 13.8 million commercial invoices
- Posted 57 million general ledger transactions
- Managed military retirement and health benefits funds ($255 billion)
- Made an average of $424 billion in disbursements to pay recipients
- Managed $20.9 billion in foreign military sales (reimbursed by foreign governments)
- Accounted for 878 active DoD appropriations

[92] http://www.defenselink.mil/dbt/faq_bea.html
[93] http://www.dfas.mil/about.html

The DoD Accounting Cycle

Using a simple example of an activity purchasing an item, we will examine the accounting cycle.[94] Of note is the difference in the accounting on the budgetary side and the proprietary side. The purposes for each account can be clearly seen in this simple example.

Event	Budgetary Accounts	Proprietary Accounts
1. Requirement for material or service identified and purchase request is made	Commitment	No event
2. Material ordered (contract signed)	Obligation, outstanding obligation, unliquidated obligation	No event
3. Material or service is received	No event	Debit Asset, Credit accounts payable
4. Pay for material or service, and match obligation and expenditure in the accounting system	Expenditure, outlay, disbursement, liquidated obligation	Credit cash balance, Debit accounts payable

You can see that the first step is establishing a commitment in the accounting system. A commitment tells others that the funds are being held in reserve, that an order is underway and should occur soon. It can be cancelled, if necessary. A commitment is an administrative reservation of funds. The government is not legally bound at this point. Commitment is purely a budgetary accounting term. The mere presence of a commitment does not represent an event in the proprietary accounts since nothing financially material has happened.

When the contract is awarded, it is no longer a commitment but is now an obligation. The government is now legally bound to make payment (presuming the contractor fulfills his agreement). At this point is it also an outstanding (or unliquidated) obligation and an undelivered order as the obligation is not liquidated, nor has the material or service been received. While a commitment is an administrative reservation of funds, an obligation is a legal reservation of funds. Again, there is no record in the proprietary accounts since the presumption we find necessary in the budgetary realm (to prevent over obligation of funds) is not material to the proprietary accounts.

When the material or services are received, it is no longer an undelivered order but it is still an outstanding obligation. Upon receipt, an accounts payable is posted and the item is expensed (presuming it is not a capital item requiring depreciation). There is no event recorded in the budgetary accounts since there has been no change in our obligation and our obligation is not yet fulfilled.

[94] Accounting has a vocabulary all its own and the author assumes many of the terms below are familiar to the reader. In the event this is an erroneous assumption, there is a glossary in Appendix A.

Finally, when the invoice and purchase order are matched at the paying office (DFAS site), a disbursement of funds is made. Since payment was made, it is no longer an outstanding or unliquidated obligation, but now an expenditure (or outlay or disbursement, they are synonymous) or a liquidated obligation in the budgetary accounts. This makes note of the fact that the obligation was fulfilled and the Treasury has made payment. On the proprietary side, the accounts payable has been satisfied and cash has been disbursed.

Problem Disbursements[95]

Occasionally obligations can't be matched with expenditures, or may be only partially matched. These conditions contribute to what are called Problem Disbursements (PDs). There are two types of PDs addressed here: an Unmatched Disbursement (UMD) and a Negative Unliquidated Obligation (NULO).

An **Unmatched Disbursement** is a transaction that has been received and accepted by the accounting office, but it has not been matched to the correct obligation. This includes rejected transactions that have been sent back to the paying office by the accounting office.

A **Negative Unliquidated Obligation** is a disbursement transaction that has been matched to the obligation but the total disbursement(s) exceeds the amount of the obligation and has created a negative obligation as a result.

It is DoD policy that a disbursement be matched to its corresponding obligation and be recorded as promptly as systems and practices reasonable permit. All disbursements must be posted promptly to liquidate the obligation in the official accounting records (maintained by the DFAS site). Account reconciliation should be conducted continuously, and DoD/DoN policy is to research and correct any potential transaction errors.

<u>For Current and Expired Accounts</u>. NULOs and UMDs must be researched and corrected within 180 days of the date of disbursement; DFAS has 120 days and the fund administering activity has 60 days. Anything outside of this 180-day window is considered to be an overaged problem disbursement. Overaged PDs must have an obligation, obligation adjustment or a reduction to unobligated balances. For appropriations scheduled to close (lapse) at the end of the current fiscal year, those obligations must be established by 30 June for all NULOs and UMDs.

As stated earlier, overaged PDs require funds obligated up to the amount of any unobligated balance remaining in the appropriation account. Unobligated, overaged NULOs and UMDs will first be processed and use any of the

[95] Readers are referred to <u>DoD Financial Management Regulations</u>, Vol. 3, Ch. 11

unobligated balance. New obligations or obligation adjustments may then be recorded, assuming any unobligated balance remains. In other words, NULOs and UMDs have first priority on any available funds.

Recall our earlier discussion of the Antideficiency Act. What if an account is fully obligated, yet still has unresolved UMDs and NULOs? The reconciliation of these PDs must go on. The correcting obligations must be posted, even if they over obligate the account and cause a violation of the Antideficiency Act to be reported.

In other words, if an account is fully obligated and has unresolved NULOs and UMDs that require an obligation, payment (disbursement) may still be made to vendors assuming the existing obligations are not fully liquidated (disbursed). Although an account may be fully obligated, it can not be over disbursed. When the account is over disbursed, payments must stop and the component shall report a violation of the Antideficiency Act.

<u>Closed Accounts and Accounts Scheduled to Close</u>. As mentioned earlier, obligations must be established by 30 June for all NULOs and UMDs in appropriations that are scheduled to close (a.k.a. lapse or cancel). If the reconciliation process puts the appropriation account into an over obligation status, the component has 6 months to bring it back into the black. If it is not brought back into a positive balance, a violation of the Antideficiency Act must be reported. Recall that subdivisions of appropriations (i.e., apportionment, allocation, budget activity, activity group, etc.) are subject to Antideficiency Act responsibility. The component may modify the number or level of these subdivisions prior to the closing of the appropriation, but when the appropriation closes no further action may be taken. The component is required to make a new cash disbursement to an appropriation that is available for the same purpose (since the original appropriation is closed) and will not exceed either the unexpended amount of the closed appropriation; the unobligated balance of the currently available appropriation; or, one percent of the total amount appropriated to the currently available appropriation. In simple terms, failure to conduct an aggressive obligation validation program 6 years ago can have a negative impact on your current dollars!

<u>Prevalidation</u>. Prevalidation is a procedure that requires a proposed payment be identified/matched to its applicable proper supporting obligation that has been recorded in the official accounting system and that the line(s) of accounting cited on the payment match the date recorded in the accounting system.

The DoD Appropriations Act of 1995 required the DoD to validate that an obligation existed prior to making a disbursement. This prevalidation threshold began at $5 million and has been reduced over the years. Prevalidation takes into account that a valid obligation exists in the accounting system prior to making payment. Before enactment of this law, disbursements were routinely made after matching the invoice with a contract and report of receipt.

Accounting Classifications

Given this background in accounting terminology, accounting processes, accounting and finance systems, and the DFAS organization, it is appropriate to discuss the accounting classification code or “line of accounting” (LOA) or more commonly referred to as fund cite. The LOA eventually links specific costs to the appropriation level, using a standard document number (SDN).

An accounting classification code or LOA is used to provide a uniform system of accumulating and reporting accounting information related to public voucher disbursements/refunds (collections). The complete accounting classification code or LOA consists of a fixed number of eleven coding elements. The Accounting Classification Reference Number (ACRN) precedes the code. The following is an example of a Navy line of accounting:

AA 1781804 0000 026 63400 3 063340 1D 000151 63580470500E

The line of accounting is broken down into its coding elements in Figure 38 - Line of Accounting Breakdown. “AA” is the Accounting Classification Reference Number (ACRN) and precedes all lines of accounting. The next ACRN would be AB, AC, etc.

The first seven positions (1721804) comprise the appropriation; the first two digits representing the department (17 = Navy), the next digit represents the fiscal year (8 = 2008) and the next four digits represent the appropriation symbol (1804 = O&M,N).

Department Code	**17**	2 or 4 digit code identifying the military department or agency receiving the appropriation, e.g., 17 is Navy, 21 is Army. Also called Department/Agency Code.
Fiscal Year	**2**	1 position code that designates the year that the funds are available for obligation.
Appropriation Symbol or Treasury Basic Symbol	**1804**	4-digit number that identifies the appropriation being used.
Subhead	**0000**	Also called a limit. 4-digit suffix to the Basic Symbol that identifies a subdivision of funds that restricts the amount or use of funds. For Navy, 1st 2 identify major command, 3rd identifies the budget activity and the 4th is for local use.
Object Class	**026**	4-position code that classifies transactions according to the nature of the goods or services procured, rather than the purpose.
Bureau Control Number	**63400**	An allotment authorization number consisting of a 2-digit budget project number and a 3-digit allotment number. For Navy, the UIC of the operating budget holder.
Suballotment	**3**	1 position code assigned by the suballotment grantor for regular suballotments.
Authorization Accounting Activity	**063340**	6-digit number that identifies the activity responsible for performing the official accounting and reporting for the funds. For Navy, a zero, then the unit identification code (UIC).
Transaction Type Code	**1D**	2 position code that classifies transactions by type (i.e., plant property, travel, etc.)
Property Accounting Activity	**000151**	For plant property, UIC of purchaser; for travel, travel order number; for R&D, the PE and project number; varies by appropriation. Often the last 6 of the SDN for Navy.
Cost Code	**63580470500E**	12 position code of OPTAR number, expense element, program element, functional/subfunctional code and cost code; 11 digit job order number and expense element for Navy.

Figure 38 - Line of Accounting Breakdown

Each service has its own unique terms for some of the above codes, and they may be found at the DFAS web site under "Accounting Classification Data Element Definitions." For guidance on Standard Document Numbers, see DFAS-CL instruction 7200.1 of 14 July 1997, available at the FMO web site http://www.fmo.navy.mil/docs/dfas-cli.pdf . Readers are also referred to the Defense Accounting Classification Crosswalk (DACC) of October 1998, available for download from the DFAS website. https://dfas4dod.dfas.mil/library/ (you must have a .mil or .gov address or VPN to access the web site.) DACC provides definitions of accounting classification data elements, a crosswalk between services use of data elements, and sample LOAs for each service. Readers are encouraged to review this document.

Fund Administration and Standardized Document Automation System (FASTDATA)

You can see that the line of accounting is lengthy and is a potential source of data entry errors. To help ensure accuracy, ASN (FM&C) has designated FASTDATA as the Navy's primary source data tool for ashore field activities. FASTDATA is an automated source document preparation system that generates accounting classification codes and interfaces with the Standard Accounting and Reporting System – Field Level (STARS-FL), the Navy's official accounting system. Transactions are initiated from cost centers and relayed through the comptroller staff (fund administrators) to the official accounting system. FASTDATA information is available at https://cust-support.dfas.mil/ . The site requires you to submit a request for a user ID and password.

Enterprise Resource Planning (ERP)

On the horizon, the Navy will implement the Enterprise Resource Planning (ERP) system. "Navy ERP is an integrated business management system that modernizes and standardizes the Navy business operations, provides unprecedented management visibility across the enterprise, and increases effectiveness and efficiency."[96] What does that mean to the analyst or comptroller? Essentially, ERP provides 'one stop shopping' for the financial management community as well as other key management and functional communities like acquisition. The Navy ERP solution allows the Navy to unify, standardize, and streamline all its business activities into one system that will achieve the highest standards for information that is secure, reliable, accessible, and current. Everyone involved in conducting the Navy's business will work using the same structures. Processes will be updated and simplified; redundancies will be eliminated; efficiencies will save money. ERP enables the Sea Enterprise, including Lean 6 Sigma initiatives, by providing a platform of integrated processes and information, standards, which unite functions and allow

[96] Assistant Secretary of the Navy for Financial Management and Comptroller, Office of Financial Operations. Available at http://www.fmo.navy.mil/systemsplanning/navy_erp.htm

rapid and informed decision making. The implementation of Navy ERP will transform Navy's business processes while driving enterprise-wide efficiencies by providing managers with enterprise-wide financial transparency and total asset visibility. More information on Navy ERP can be found at http://www.erp.navy.mil/index.cfm Students can expect ERP to be coming to their command in the next year or two. As of this writing, NAVAIR will be the first command to implement ERP in October 2007.

Prompt Payment Act (PPA)

The Prompt Payment Act (Public Law 97-177) was signed into law on May 21, 1982 and was amended on October 17, 1988 (Public Law 100-496). The PPA requires federal agencies to:

- pay their bills on time,
- take discounts only when payments are made by the discount date, and
- pay interest penalties when payments are made late

Paying on time means not paying early (no earlier than the 23rd day) and not paying late (no later than the 30th day).[97]

Payment terms may be specified in a contract and payment will be made per those specifications. However, if no payment terms are specified, then payment will be made based on the following:

- Payment will be made as close as possible to, but not later than, 30 calendar days following the *latter of the following three events*:[98]
  - Receipt of the goods or services (execution of a valid, signed contract)
  - Receipt of the invoice by the activity designated in the contract to receive the invoice (normally the consignee)
  - Acceptance of the goods or services, using either the actual or constructive acceptance

Normally an invoice is attached to the goods or it may be mailed. The activity has 7 days to contact the contractor in the event an invoice is not received after receipt of the goods or services. Per the FAR and DFARS, a *proper invoice* must be submitted by the contractor. What constitutes a proper invoice?

1. Name and address of the contractor
2. Invoice date (used by the paying activity if the receipt date is not annotated)
3. Contract number
4. Description, quantity, unit of issue, unit price, and extended price
5. Shipping and payment terms (PPA discount terms)

[97] DoD Financial Management Regulation, Volume 10, Chapter 7, paragraph 070101.B.2.
[98] DoD Financial Management Regulation, Volume 10, Chapter 7, paragraph 070205.A.

6. Name and address of the contractor official to whom payment will be sent
7. Name, title, address and phone number of a person to be notified in the event of a defective invoice
8. Any other information deemed necessary by the contracting officer

Acceptance occurs after the receipt and testing/inspection (if required) of the goods or services. Acceptance is a formal certification that the goods or services conform to the terms of the contract. The acceptance date normally conforms to the date shown in block 21 of DD Form 250 (Material Inspection and Receiving Report) or block 26 of the DD Form 1155 (Order for Supplies or Services). Otherwise, the date that is stamped on the invoice as the acceptance date will be used. However, one must consider *constructive* acceptance. Unless otherwise specified, constructive acceptance is considered to occur *not later than 7 days after receipt of the goods* or services unless there is disagreement over quantity or quality. So what does this mean? *Simply stated, you must accept the goods or services within 7 days after receipt of such or it is assumed received*. If the actual acceptance falls in between the receipt of the goods and the constructive acceptance date, then the actual acceptance date will be used.

Once the material/service ordered has been properly received, accepted and certified, the certifying activity will forward the certified invoice and the purchase order to its assigned bill paying activity (DFAS). It is essential that the receipt, acceptance, and invoice certification process be completed as quickly as possible to avoid costly interest penalties.

As noted above, the payment period commences based on when the invoice is received, when the material/service is received or when the material or service is accepted, *whichever is later*. The payment period ends as of the date cited on the U.S. Treasury check (or electronic funds transfer (EFT)) accomplishing the payment. Interest penalties will be paid whenever payment is not made by the expiration of the applicable period. Interest is computed from the day following the payment due date through the date of payment, and will be compounded each thirty calendar day period following the original due date. In most instances, the rate used to compute interest is provided semiannually to the Department of Defense by the Treasury Department and is payable from the date payment is due to the date it is paid. The Prompt Payment Act stipulates that the interest is compounded every 30 days with accrual *up to 1 year*.

If interest is due to be paid to a contractor, then it should be paid without the contractor having to request the payment. An additional interest penalty is due to contractors if all of the following conditions are met:

- The contractor is owed interest
- The interest was not paid with the invoice payment to the contractor on the date the interest became due

- The contractor was not paid the interest within 10 days after the date on which the invoice was paid
- The contractor makes a written request NLT 40 days after the date on which the payment was made

The additional penalty will equal 100 percent of the original interest payment but will continue to accrue until the payment is made (not subject to the 1-year time restriction discussed above). The additional penalty will be greater than $25 and no more than $5,000.

Below are some scenarios for computing the start date for the 30 day clock.

- Receipt of the goods 10 June
- Receipt of the invoice 10 June
- Acceptance of the goods 15 June

    - In this example, the 30-day clock begins on 15 June. This example is fairly easy to understand.

- Receipt of the goods 10 June
- Receipt of the invoice 16 June
- Acceptance of the goods 15 June

    - In this example, the 30-day clock begins on 16 June, as the *invoice is required* for certification.

- Receipt of the goods 10 June
- Receipt of the invoice 13 June
- Acceptance of the goods 19 June

    - In this example, the 30-day clock begins on 17 June, as one must use the *constructive acceptance* date. Note that acceptance occurred 9 days from the receipt of the goods and exceeds the constructive acceptance period of 7 days; therefore, add 7 days to the receipt of the goods date and use the constructive acceptance date.

Chapter 11: Critical Aspects of Budget Execution

What is meant by the term "budget execution"? Answers vary widely, but transform to a single basic theme: to obligate (or expend) the allocated resources within legal constraints so that the program financed by the allocation achieves its objectives. Included in this definition are concepts such as adhering to principles of fiscal law, achieving obligation and expenditure rates, ensuring accountability for the funds, moving funds as necessary to best achieve program goals, and doing so without risking future budgets.

Throughout the year of execution, it is important to monitor budget execution. A budget is a plan, and when appropriated, became the legal basis for the purpose, time, and amount aspects of the installation, program or activity that submitted the budget. The Navy is required to execute that budget as presented and as enacted. The installation, program, or activity must demonstrate that they can meet congressional intent. There are several tools and metrics at our disposal to manage execution.

Outstanding Obligation Validation

Every activity should continuously perform outstanding obligation validations. Fund holders are required to review commitments and obligations three times a year during each of the four-month periods ending 31 January, 31 May and 30 September of each fiscal year.[99] But one should not wait for those times; it should be a continuous process. Transactions such as cancellations in an obligation status should be corrected. Overaged commitments should be researched and a determination made if there should be obligations or commitments cancelled. Receipts should not be shown as still in an obligation status. Memorandum records should match the official accounting records.

These validations are particularly important as the appropriation ages. Corporate memory fades, records are displaced, and time is short. As the appropriation nears its closing date (fifth year of expenditure availability), it becomes obvious that a continuous validation process pays off. All unliquidated obligations must be researched and settled early in the fifth year to prevent any impact to current year funds.

Obligation and Expenditure Rates

The obligation rate is determined by dividing the amount of obligations by the funds authorized. The obligation rate, expressed as a percentage, should track with the goals set by USD(C). The DoD Comptroller is required to set obligation rules per 10 U.S. Code section 2204. Each appropriation has obligation rate targets that activities and programs are expected to achieve.

[99] DoD Financial Management Regulations, Volume 3, Chapter 8, paragraph 0804

The expenditure rate is determined by dividing the expenditures by the funds authorized. The expenditure rate, expressed as a percentage, should be tracking to the goals set by USD(C). Each appropriation has different expenditure goals, often called the "expenditure tail." Why are expenditures monitored closely? Because they directly affect outlays, and outlays are monitored by the Congress.

A program or activity that is under obligating (or under expending) appears to be mis-managed or excessively funded. One that is over obligating (or overextending) likewise appears to be mis-managed.

Early in the second quarter of the fiscal year, a midyear review is conducted to ensure current funding levels are adequate. Those under executing may face the possibility of losing some funding. Those with compelling unfunded requirements may see additional funds flow their way. This review is an opportunity for the various layers in the chain of command to review budget execution performance and adjust for fact-of-life changes.

The following table (Figure 39 - Expected Obligation and Expenditure Rates for Various Appropriations) displays a few appropriations and their expected obligation and expenditure rates. The first line of each appropriation shows the obligation rate and the second line lists the expenditure rate. You can see that the annual appropriations have much faster outlay rates than the investment appropriations. This is to be expected given the purpose of those appropriations. MilPers, for instance, expends when the paycheck is issued, so one should expect execution rates in the high 90s.

O&MN	100.0%	-	-	-	-	-
	74.0%	95.2%	97.9%	99.1%	99.5%	99.5%
MPN	100.0%	-	-	-	-	-
	97.0%	99.7%	99.8%	99.8%	99.8%	99.8%
RDT&E,N	92.9%	100.0%	-	-	-	-
	55.0%	91.0%	98.0%	99.0%	99.5%	99.5%
APN	84.0%	96.0%	100.0%	-	-	-
	15.0%	55.0%	83.6%	93.6%	98.1%	99.5%
SCN	47.4%	73.5%	88.1%	94.7%	100.0%	-
	15.0%	40.0%	60.0%	75.0%	87.5%	96.0%

Figure 39 - Expected Obligation and Expenditure Rates for Various Appropriations

Lastly, you must monitor the "twenty-two rule" which states that you are prohibited from obligating more than 20 percent of your budget authority in the last two months of the fiscal year. In other words, an activity should have obligated at least 80% of the budget in the first 10 months of the fiscal year. This is a general provision of each National Defense Appropriations Act.

This rule is directed as a general provision in the DoD Appropriations Act and monitored by USD(C) at the appropriation level. Obligations for the fourth quarter are not to exceed the obligations of the third quarter, and orders for supplies will be kept to essentials only – recall the *bona fide needs rule* for appropriations.

Transfers and Reprogramming

Recall from Chapter 7 that appropriations come with transfer and reprogramming authority. Given the long lead time from programming decisions to budgeting to enactment to execution, many changes may occur which can affect a program but will not be reflected in the budget. Transfer and reprogramming tools exist to assist the department in managing the funds during execution. Transfers are the movement of funds between appropriations and reprogramming is the movement of funds within an appropriation. DoD is expected to execute programs as enacted, but that is not to be blind obedience, and executive branch agencies are given these tools as a form of delegated authority to make adjustments. These adjustments are within certain thresholds as specified by Congress.

Other Budget Execution Points

There are several other metrics used in managing the execution of a budget. Each program, activity or installation is a little different, but here are some key examples:

- **Civilian Full-Time Equivalent (FTE) Rates.** Most budgets contain a civilian labor FTE figure. Managing this metric early in the year is vital since it becomes nearly impossible to adjust late in the year. An activity simply can't hire a lot of employees late in the year to correct under execution and it is ill advised to involuntarily separate or furlough employees late in the year due to over execution. Civilian personnel management is covered in the next chapter.

- **Funding Architecture**. Funding floors, ceilings, and fences were established in many categories. The activity comptroller must ensure those targets are hit. Recall, that funding earmarks are tools Congress uses to set the level of effort for a particular function. During execution, areas of spending such as Sustainment, Restoration, and Modernization (SRM), child development centers, appropriated fund support to Morale, Welfare and Recreation (MWR), travel, and advisory and assistance services require additional monitoring. In addition, service components and MAJCOMS may also add some of these restrictions as well.

- **Congressional Interest Items**. Some budget line items are designed as special interest items. These receive higher levels of scrutiny within DoD and Congress. If you manage funds related to one of these programs, it demands increased vigilance.

- **Acquisition Programs**. Major acquisition programs have unique execution management issues. The supporting financial managers must stay abreast of technical developments and milestones to understand the budgetary and execution impacts. A slipped approval to enter production will certainly affect execution of both the RDT&E and procurement accounts. Supporting financial managers must also be proficient in Earned Value Analysis (EVA) or Earned Value Management (EVM)…a method for monitoring program performance as well as financial execution. EVA/EVM will be discussed briefly in the Contracting Overview chapter of this text. For a more detailed discussion, readers are referred to Acquisition Reform, Defense Acquisition University or the Naval Postgraduate School program management resources.

Other Touch Points and Lessons Learned In Execution

There are some things about execution that can only be learned by actually executing funds. At the end of the day or year, the only thing a Comptroller really has is their credibility. One of the main ways to establish and maintain credibility is to know your program. While that may sound trite, it will help distinguish good comptrollers or analyst from the others. Below is a collection of examples to help students get to know their program

- Be able to communicate the program position or anomalies to the higher HQ, especially when surging or lagging in execution.
- Be able to answer the questions immediately. Certainly, all questions can't be answered immediately but the majority of questions should be answered without consuming lots of time hunting down the answer. Frequent hesitation to answer questions indicates lack of understanding.
- Provide information without being asked. This sends a message that the program is being attended to.
- Read the governing documents. There are usually multiple documents that support a program. They usually can answer why a program procures the goods and services that it does. Understanding the source that drives the requirement helps in answering questions and in defending budgets or unfunded requirements.
- Know the policies and regulations governing the area of execution being worked. This sounds incredibly obvious but is often an area that causes

tremendous churn. Seek out sources for policy updates and get connected to them.

- Talk to the customer. In the age of computers and cell phones, we often neglect getting out of our chair for face-to-face discussions. This is a valuable technique. Remember it's a lot harder for someone to say no to your face than in an email.
- Attend program reviews, meetings, conferences or other forums where the program may be discussed. This will help gain an understanding of the current challenges or triumphs of the program and may provide an opportunity to inject guidance or solutions.
- Build alliances. No one in government acts alone. Most jobs or tasks require engagement with multiple peers, activities, or outside agencies. Get to know those who will help move the work forward. Once they know who they are dealing with, road blocks are reduced and work gets accomplished more easily.

Those are just some techniques that can be used to help build credibility. Students are encouraged to explore other ways and develop their style and techniques. The end result is that good credibility will be rewarded! Here are some potential ways in which commands can be rewarded:

- Higher headquarters may offer extra funds when opportunities arise
- Customers will engage comptrollers BEFORE taking unilateral action
- Others will recognize the comptroller as a valuable resource

All of this can contribute to smooth execution and mission success!

Chapter 13: Contracting Overview

Overview

In this chapter a broad overview of the contracting function and a discussion of contracting terms in a general nature will be provided. A contract is the vehicle by which we obtain the majority of our goods and services from the private sector. One of the management tools used to manage contracts based on integrating cost, schedule and performance is called Earned Value Management or EVM. At the request of students, a brief overview of EVM has been added to this chapter.

What is a Contract?

A contract is a legal agreement that creates duties and obligations. Each contract has minimal essential elements in order to be legally enforceable. Those elements include:

(a) at least two persons with the legal capacity to act;
(b) consent to the terms of the contract through offer and acceptance;
(c) mutual consideration (some form of payment or benefit received);
(d) is for only legal purposes; and
(e) is sufficiently clear so both parties agree on the essence of the contract
.

Objectives and Functions of Contracting

The objectives of the contracting process are to acquire the needed systems, supplies and services at the best value; have them delivered on time and within an acceptable level of quality; support socioeconomic policies; and to retain the vital national industrial base. The contract itself serves several functions:

- Evidentiary function – it is a baseline for future reference
- Administrative function – it serves as a framework for accountability
- Risk Allocation function – risk can be allocated between the government and the contractor through pricing, schedule, and performance parameters
- Motivation function – incentives, awards, and pricing structures create incentives
- Payment function – the contract specifies costs which are allowed, allocable, and reasonable as well as the means for making payment.

Socioeconomic Programs

The federal government assumes responsibilities beyond spending the taxpayer's dollar most efficiently and effectively, therefore "best value" takes on expanded meanings. Government uses the contracting process to advance other goals, such as creating opportunities for traditionally disadvantaged citizens or for underutilized businesses, to enforce environmental laws, to manage trade balances and to maintain industries vital to national security. Examples of these programs include:

- Small businesses
- Minority-owned businesses
- Women-owned businesses
- Blind and handicapped programs
- Prison-made products (UNICOR)
- Buy American Act
- Clean Air Act
- Labor Surplus
- Davis-Beacon Act (construction)
- Services Contract Act
- Walsh-Healy Act (supply contracts)

Competition in Contracting Act (CICA)

Contracting officers are to promote and provide for full and open competition in soliciting offers and awarding government contracts through the use of competitive procedures. Exceptions to CICA are for only one responsible source, urgency, statutory requirements, national security or if necessary in the public interest.

The FAR

The Federal Acquisition Regulation (FAR) is the primary directive for contracting and procurement, applying to the acquisition of all systems, goods and services. The FAR is available online at http://farsite.hill.af.mil/VFFARA.HTM

FAR guiding principles are to work together as a team to build a system that will work better and cost less to deliver the best value product or service to the customer. Its objectives are to satisfy the customer, minimize administrative costs, conduct business with integrity, and fulfill public policy objectives.

The FAR principles state: do not assume that practices not otherwise prescribed or required are prohibited and interpret the absence of direction as an opportunity to innovate, consistent within sound business practices and the law. This is significantly different from the discussion in Chapter 7 on fiscal law where specific authority is required before a purchase can be made. These two sources account for much disparity and tension between financial managers and operators. In financial management, absence of direction does NOT equal permission to purchase. Fiscal law requires us to have positive authority to purchase. In other words, we must show where we are authorized to purchase an item and not assume we may purchase an item because there is no evidence that says we can't.

Uniform Contract Format

Per the FAR 15.204-1, a uniform contract format is specified. It contains four parts, consisting of the following elements:

A. Solicitation/contract form
B. Supplies or services and prices/costs
C. Description/specifications/work statement
D. Packaging and marking
E. Inspection and acceptance
F. Deliveries or performance
G. Contract administration data
H. Special contract requirements
I. Contract clauses
J. List of attachments
K. Representations, certifications, and other statements from offerors
L. Instructions, conditions and notices
M. Evaluation factors for award

Contracting Spectrum

The following is an "A to Z" overview of the contracting spectrum, or steps required:

1. Determination of requirements
2. Communication of the requirements
3. Method of procurement determined
    - Sealed bids
        - Fixed price type
    - Competitive or sole source proposals
        - Fixed price type
        - Cost reimbursement
4. Solicitation of sources
    - Request for Proposal (RFP)
    - Invitation for Bid (IFB)
5. Response and evaluation
6. Award of contract
7. Post-award contract administration
8. Delivery and contract completion
9. Contract closeout

Contract Types

The types of contracts may vary according to the degree and timing of the responsibility assumed by the contractor for the costs of the performance, i.e., *risk*. Also, the amount and nature of the profit incentive offered to the contractor for achieving or exceeding specified standards, i.e., *opportunity*.

We will discuss the **fixed price** contract and the **cost reimbursement** contracts. Essentially, the fixed price contract is where the government pays a price, subject to some fixed maximum ceiling amount if a sharing incentive is used. The cost reimbursement contract is where the government pays the cost, subject to limitations on costs that are *allowable* and *allocable*, and *cost reasonableness*.

Both types have many variations, using an award fee (for qualitative measures) and incentive fee (for quantitative measures) structure. Within these categories we find the most common types of Firm Fixed Price (FFP) -- high risk to the contractor, Fixed Price Incentive (FPI), Cost Plus Incentive Fee (CPIF), Cost Plus Award Fee (CPAF) and Cost Plus Fixed Fee (CPFF) -- high risk to the government.

Fixed Price Contract

A fixed price contract is for a firm requirement that is well defined. Payment is made after delivery of the goods and the contractor's profit is based on performance or by controlling costs. The risk to the contractor is high, and the risk to the government is low. These must be done with an IFB or RFP.

- **Firm-fixed-price**. Establishes a fixed-price for the product or service being procured that can't be changed unless the scope is changed.

- **Fixed-price incentive**. Provides for adjusting profit and establishing a final contract price by a formula based on the relationship of the final negotiated total cost to total target cost.

Cost Reimbursement Contract

A cost reimbursement contract levies higher risk on the government and less risk to the contractor. The contracts are based on the "best efforts" of the contractor, and payment is made as the costs are incurred. The fee or fee formula are agreed upon in advance. These must be done via RFPs only.

- **Cost**. Provides for reimbursement of costs but no fee.

- **Cost-sharing**. The contractor receives no fee and is reimbursed only for an agreed-upon portion of allowable costs.

- **<u>Cost-plus-incentive-fee</u>**. Provides for an initially negotiated fee to be adjusted later by a formula based on the relationship of total allowable costs, schedule or performance to total target costs, schedule or performance.

- **<u>Cost-plus-award-fee</u>**. Provides for a fee consisting of a base amount (limited to 3% of estimated cost) fixed at inception of the contract plus an award amount based upon a judgmental evaluation by the Government.

  - **<u>Cost-plus-fixed-fee</u>**. The contractor and the Government negotiate the estimated cost of performance for the requirements. Based upon that estimate, a fixed fee is determined and the contractor will receive that fee regardless of the actual cost to perform the work. If the contractor's actual costs reach the estimate and the government wants the contractor to continue work, the contracting officer must provide the contractor with funds to continue, but no additional fee.

Other Contract Types and Agreements

<u>Indefinite Delivery Contracts</u>: Used when the exact times and/or quantities of future deliveries are not known at the time of contract award. This can be for a definite quantity for a fixed period; for all actual purchase requirements for specific supplies or services during a specified period; or, for an indefinite quantity within stated limits, of specific supplies or services during a fixed period.

<u>Letter Contracts</u>: A preliminary contractual instrument that authorizes the contractor to begin work prior to negotiation of specific terms. It includes a ceiling price and a limitation of Government liability, which is usually 50% of the ceiling price.

<u>Time and Materials Contract</u>: Specifies direct labor hours at a specified fixed hourly rate (including all overhead and profit) and materials at cost. Hours and material can then be purchased up to a specified ceiling.

<u>Labor-Hour Contract</u>: Variation of a time and materials contract where only labor is purchased.

<u>Agreements:</u> Two types of agreements exist, the Basic Agreement and Basic Ordering Agreement (BOA). Though Basic Agreements are not a contract they contain clauses applying to future contracts between the parties during its term, contemplating separate future contracts that will incorporate by reference or attachment the required and applicable clauses agreed upon in the basic agreement. A BOA is similarly not a contract but contains terms and clauses applying to future contracts (orders) between parties during its term and a description, as specific as practicable, of supplies or services to be provided and methods for pricing, issuing and delivering future orders under the BOA.

Contract Management

One of the techniques that program offices use to manage large contracts is called Earned Value Management or EVM. EVM is a tool that effectively integrates cost, schedule, and technical performance management of a contract. It is designed to provide "early warning" of impending cost, schedule or performance issues. EVM allows a contracting officer/manager to assess contract performance by identifying if a contract is over/under budget and if it is ahead/behind schedule. It is used in all significant cost type contracts and other contracts that require integrated cost and schedule monitoring.

The earned value concept relates resource planning to schedules and technical performance requirements. Key features include:

- A plan for all work associated with a program from start to completion
- Integrated program work scope, schedule and cost objectives into baseline plan and measures progress against the baseline
- Objective assessment of the progress at the work performance level
- Analysis of variances from the plan and forecasts impacts
- Relevant program performance data to decision-makers

EVM is based on the work breakdown structure (WBS). WBS provides "what" must be accomplished into smaller "work packages". Work packages are then scheduled, which provides "when" work will be accomplished from start to finish. The contractor then assigns each work package to a "cost account" within the company, which provides the "who" is responsible for the work on a scheduled timeline. It also identifies the "cost" to perform the scheduled work.

Some terminology is helpful before illustrating EVM in an example.

Performance Measurement Baseline (PMB) – PMB is the sum of all work packages as identified by completion date (time). This creates a time-phased budget plan. In short, the PMB is the budget and is stated in dollars. This term is also known as the Budgeted Cost of Work Scheduled (BCWS). For example,

Task	Amount	Start	Complete
A	$100K	1 Oct 07	1 Dec 07
B	$50K	1 Nov 07	1 Feb 08
C	$200K	1 Feb 07	1 Jul 08
…n			

Budget At Completion (BAC) – Simply stated, the BAC is where PMB (the baseline budget) is at the end of the project schedule. It tells the total expected cost of the program upon completion.

Actual Cost of Work Performed (ACWP) – This is the actual cost of work performed at a point in time.

Budgeted Cost of Work Performed (BCWP) – This refers to the budgeted cost of work performed at any point in time. One would expect BCWP to equal to the PMB at the same point in time but it may differ if some of the work packages are completed out of sequence or with an unexpected delayed.

Cost Variance (CV) – Much like in budget execution, this is merely the difference between the BCWP (budget) and the ACWP (actual). The formula looks like this: CV = BCWP – ACWP. If the result is a negative number, then the contract is over budget. If it's positive, the contract or program is under budget.

Schedule Variance (SV) – Again, this is similar to budget execution (comparing actual to budget) only here we are looking at schedule and comparing the planned schedule (time phased work packages in the baseline PMB or BCWS) to planned/budgeted work that is completed (BCWS). The formula looks like this: SV = BCWP – BCWS. If the result is a negative number, then the contract is behind schedule. If positive, the contract is ahead of schedule.

To examine this concept more closely, let's look at a simple example. Figure 40 - Performance Measurement Baseline shows the work packages and their associated budget that are time phased based to completion. The amounts are graphed on the PMB line (also known as BCWS). The BAC indicates the PMB at completion.

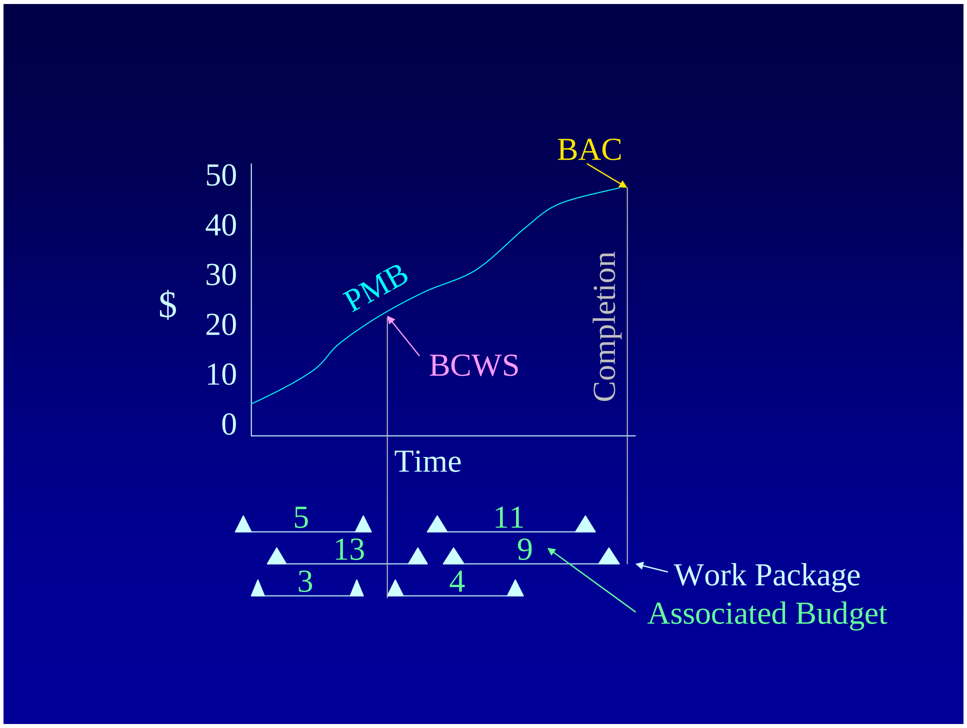

Figure 40 - Performance Measurement Baseline (PMB)

Let's assume that we want to check the performance shortly after the halfway point. Figure 41 - Actual & Budgeted Cost of Work Performed shows the actual cost of work performed (ACWP) and the budgeted cost of the work (BCWP) that has been performed so far.

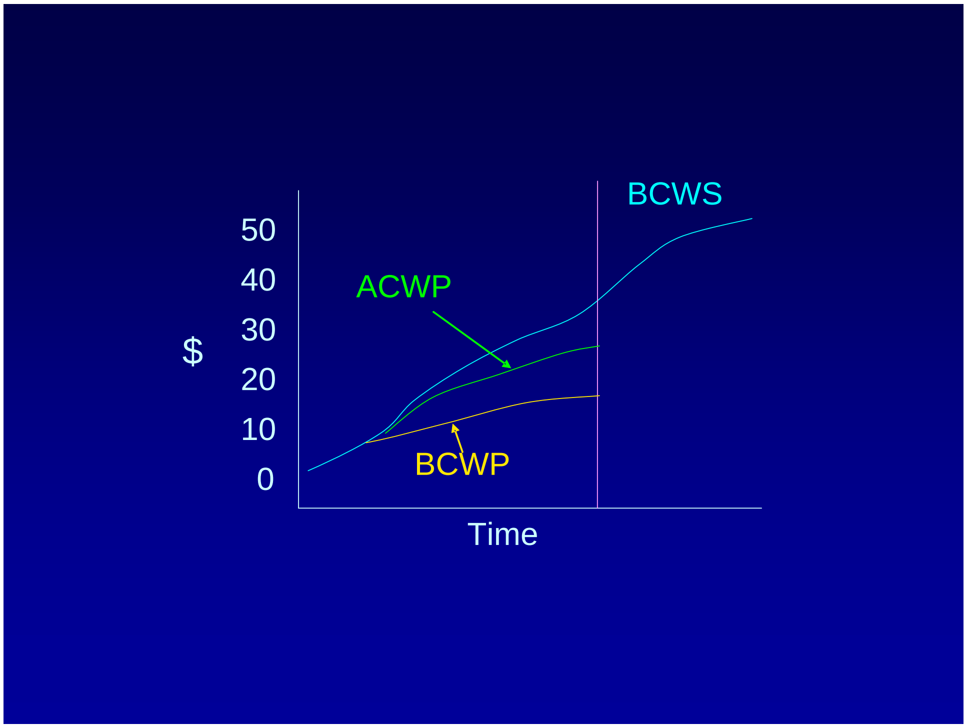

Figure 41 - Actual & Budgeted Cost of Work Performed

Now let's look at the cost variance and schedule variance. Figure 42 – Cost Variance and Schedule Variance shows the variances and how they are calculated. You can see that the CV = - $10 indicating the project is over budget. The SV = - $5 indicating that the project is behind schedule.

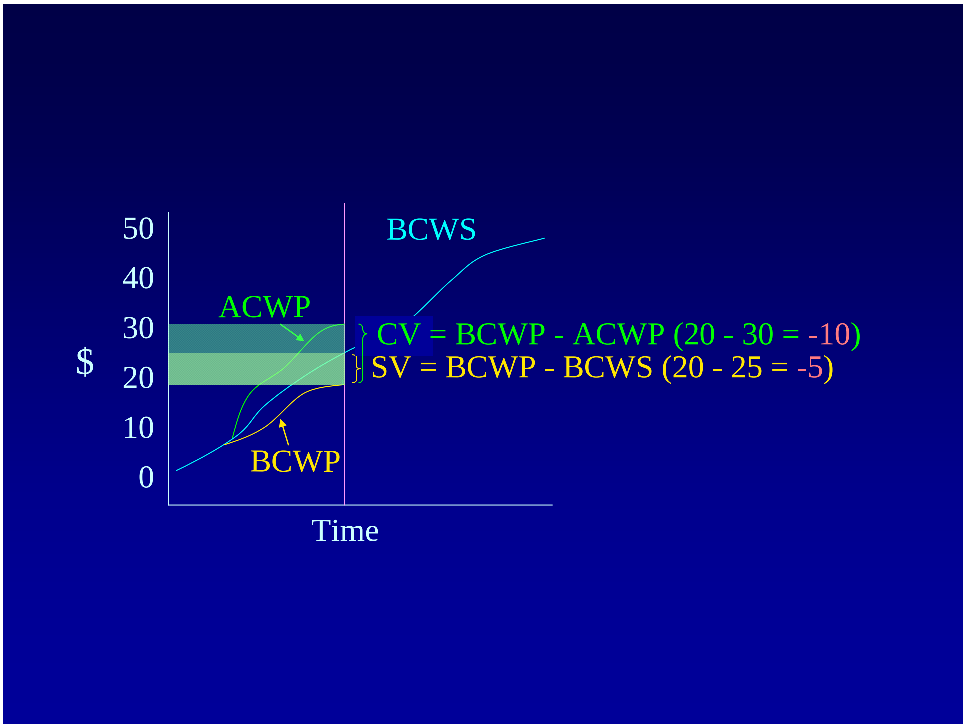

Figure 42 – Cost Variance and Schedule Variance

EVM has more in depth calculations that can be performed to determine ratios instead of dollars but they are beyond the scope of this discussion. Since EVM is more closely related to contract management, it is primarily taught in contracting and acquisition curriculums and in Defense Acquisition Workforce Improvement Act (DAWIA) certification programs. Students should have an awareness of EVM and could certainly expect to see it in the Certified Defense Financial Management Acquisition (CDFM-A) module and certification test.

Chapter 14: Management Controls and Auditing

Overview

This chapter examines the DoD Manager's Internal Control (MIC) program; an important aspect of management control and the audit function. Management controls and property accounting have been cited as material weaknesses within DoD. As stewards of the public trust, it is important that we have adequate controls to provide reasonable assurances that assets under our control are properly managed and accounted for, that processes produce the outputs expected, and that programs achieve the outcomes expected.

Introduction to Management Controls

Management controls (MC) or internal controls (IC) are how we control and safeguard our resources, which include manpower, dollars and property. Since we are dealing with public funds and assets, we have a plethora of guidance on management controls:

- Federal Manager's Financial Integrity Act (FMFIA) of 1982
- OMB Circular A-123 Management Accountability and Control
- DoD Instruction 5010.40 Management Control Program Instruction (gives the how)
- GAO Standards for Internal Controls in the Federal Government
- SECNAVINST 5200.35E

What is a Control?

A control is a collection of cost-effective procedures to provide *reasonable assurance* that programs achieve their intended results; resources are used only in support of the mission; waste, fraud and mismanagement are prevented; statutes and regulations are followed; and information on which decisions are made is reliable and timely.

Some examples of controls are organizational structures, policies and procedures, a budget, and padlocks on warehouses.

Controls come in two forms: proactive and reactive. Proactive, or preventive, controls are ex ante – they create a safeguard or provide a standard of compliance before action is taken. Some examples include employee safety programs, toxic waste limits for industrial effluent, comptroller certification of funding documents, and bar-coding of inventory items.

Reactive, or detective, controls are ex post – they rely on documentation and records to ensure compliance and effectiveness after action is taken. Some examples include travel claim audits, obligation validation reviews, and water test samples to ensure quality.

Balance of Controls

It is important to strike a careful balance of controls. Too many proactive controls impede progress and efficiency. Too few lead to non-standardized performance and ineffectiveness. In general, too little control can lead to the violation of statutes and regulation, provide unreliable information, result in lost assets, programs that fail to achieve goals, and create opportunity for fraud. On the other hand, too much control can stifle initiative, dampen morale, and be labor intensive.

Because a comprehensive management control program would duplicate many of the reviews required by other authority, the Navy position is to give the local commander broad authority over the content and nature of each activity manager's internal control program. SECNAVINST 5200.35E states, DON personnel are responsible for the proper stewardship of Federal resources as a basic obligation of their public service in accordance with references (a) and (b). They must ensure government resources are used in compliance with laws and regulations, are consistent with mission, and present minimal potential for waste, fraud, and mismanagement. Managers should not be encumbered by controls but rather benefit from them. Managers must ensure an appropriate balance between too many and too few controls. MIC programs shall encompass the GAO's five standards for IC:

1. Control Environment,
2. Risk Assessment,
3. Control Activities,
4. Information and Communications, and
5. Monitoring.

The design, operation, and documentation of the organization's programs should meet the objectives of reasonable assurance. Those objectives are:

1. Effectiveness and efficiency of operations;
2. Reliability of financial reporting; and
3. Compliance with applicable laws and regulations.[100]

GAO's Standards for Internal Controls

As mentioned, GAO has five standards for internal controls in the government, and these are considered the minimum standards:

[100] SECNAVINST 5200.35E of 8 November 2006

1. **Control environment**: Employees and management should have an attitude about management controls that is positive and supportive throughout the organization.

2. **Risk assessment**: The internal controls should provide for an assessment of the risks from internal and external sources. Risk is discussed further below.

3. **Control activities**: Control activities should address any risk identified in the risk assessment. The internal control activities should be effective and efficient, ensuring management's directives are carried out. The nature of controls was discussed above.

4. **Information and communications**: For efficient and effective operations, an organization needs timely information that is relevant and reliable, and is communicated to the <u>entire</u> organization. This includes training. Many management control programs are well designed, but if they are not known or practiced, they are ineffective.

5. **Monitoring**: The internal control monitoring should assess the performance over time and occur over the course of normal operations without requiring undue difficulty. This does not refer to monitoring the organization (which is part of control activities), but rather monitoring the management control process itself. While management controls provide for organizational efficiency, it is possible to have inefficient or ineffective controls. Those with significant management control responsibility should have performance criteria and performance appraisals that reflect that responsibility.

Material Weaknesses

The Navy is required to identify, report, and correct material weaknesses. What is a material weakness? Material weaknesses should cover significant issues, answering questions such as: is it DoD/DoN wide and systemic; is there significant Congressional interest; and, is there heavy media interest. Weaknesses can occur at the Department level, component level, major command level, or at the field activity level.

Corrective action plans should be developed for each material weakness. Correction should take place in a timely manner and achieve effective results. The Navy reports material weaknesses on the annual FMFIA Statement of Assurance. This is sent to the President by 31 December of each year. The agency head must provide a statement of assurance (meaning no significant weaknesses exist), a qualified statement of assurance (meaning there may be weaknesses but they might be minor or correction is in progress), or a statement of no assurance (there are so many weaknesses it's difficult to give any assessment).

Risk Assessments and Assessable Units

What processes and activities require internal controls? Certainly an activity does not need or desire to have an internal control staff so large that all functions are monitored. The activity should conduct routine risk assessments of its core business and operational functions. The risk assessment should ask this set of questions: what could go wrong? how likely is it to go wrong? what is the consequence if it does go wrong? Given this risk assessment, the more vulnerable areas should have a set of internal controls to guide them. These areas are referred to as *assessable units*. SECNAVINST 5200.35E provides suggestions for assessable units. Those in the comptroller function include: unmatched disbursements, financial accounting, property accounting, voucher payment and fund accounting. An inventory of assessable units must be maintained and managed as part of the local management control program.

The Audit Function

What is an audit? An audit is a comprehensive review and report on the performance of an activity or program. It may report on the financial or material condition of the activity. The intent of auditing is to improve the condition and efficiency of the area being audited.

Government Accountability Office (GAO) Standards

The GAO standards are delineated in the *Government Auditing Standard*, often called the "Yellow Book." It is available at http://www.gao.gov. These Generally Accepted Government Auditing Standards (GAGAS) apply to audits of government organizations and programs, and contractors receiving assistance from the government. Other requirements are delineated in the CFO Act of 1990 and the Government Performance and Reporting Act (GPRA) of 1993.

GAO has established general standards and specific controls for audit controls. The four general standards include:

1. Independence – impartial decisions are to be made
2. Due professional care – sound judgment should be used by the auditors and they will exercise due care, adhering to Generally Accepted Government Accounting Standards (GAGAS)
3. Competent personnel – the staff conducting the audit is qualified.
4. Quality control – each audit organization will have an appropriate internal control system in place and will have an external quality control review

Types of Audits

There are four basic types of audits described below:

Financial Audits

- Predetermined objectives
- Determine if the financial information is in compliance with laws, directives and statutes
- Ascertain if the organization has internal controls of financial reporting and the safeguarding of assets

Contract Audits

- Determine compliance with the terms of the contract
- Normally collect physical evidence to determine if the product or service conforms to the terms of the contract
- Determine if the contractor is performing to the terms of the contract

Performance Audits

- Determine the performance level of the organization by using standards that would vary for each organization, depending on its structure and mission
- Determine if the organization is accomplishing its mission within the guidelines of laws and regulations and if the programs are achieving the intended results
- Provide causes for poor performance and recommended actions to improve performance

Computer Processed Data Audits

- Assess the reliability of computer processed data
- Look for an audit trail and the completeness of the data
- Verifying the accuracy of source transactions by manually duplicating the process and comparing the results

Three Phases of a Government Audit

Three phases must exist for government audits: planning, reviewing and reporting.

1. **Planning Phase**

   First, an overall audit plan will be developed. It will select issues to review and look at the materiality and significance of those issues. The plan should address the organization's ICs and address current issues.

2. **Review Phase**

   The review phase begins with the gathering of evidence. Consideration will be given to prior audit findings and prior performance, as well as determining if recommendations were considered and implemented.

The evidence gathered is to be significant --- is it important in relation to the audit objectives? The evidence must also be material in nature --- what is the magnitude of the omission or misstatement regarding the information? Would such have influenced or changed the outcome?

3. **Reporting Phase**

   All audits require a written report to address the objectives of the audit, the findings, and any applicable recommendations. Financial audits must address the following areas:

   - If the statements presented were in accordance with GAGAS
   - If the information in the statements were adequate
   - Identification of times when the standards were not observed
   - An overall statement of opinion regarding the financial statements, or a statement as to why an overall opinion can't be given

An Example of Manager's Internal Control: Property Accounting

Government employees are not only charged with safeguarding funds, but are charged with accountability over the items procured with the taxpayers' dollars. One of the material weaknesses cited in recent audits of the Department's financial statements regards controls on property accounting. The Federal Managers' Financial Integrity Act (FMFIA) of 1982, Title 10 U.S. Code section 2721, and the Federal Accounting Standards Advisory Board require federal agencies to provide reasonable assurance towards the safeguarding of funds and assets. In addition, the DoD requires that assets be under continuous accounting controls from the time of acquisition to disposal. Much of this section is taken from the DoD Financial Management Regulations (Volume 4, Chapter 6) and SECNAV Instruction 7320.10A.

Personal Property

Personal Property is defined as those items used, but not consumed, to produce goods or services in support of DoN's mission. Personal Property includes: office equipment, industrial plant equipment, vehicles, material handling equipment, Automated Data Processing (ADP) equipment, government furnished equipment (GFE), and other types of assets. It does <u>not</u> include inventory items held for sale, operating materials or supplies, real property (land, buildings), or items of an historic nature.[101]

Personal Property is part of the larger hierarchy of materials categorized as Property, Plant and Equipment (PP&E). There are three categories of PPE: Heritage Assets, Stewardship Land, and General PP&E. Briefly, Heritage Assets includes items of historical, cultural, educational or artistic importance;

[101] SECNAVINST 7320.10A of 1 April 2004

Stewardship Land is land not acquired for or in connected with General PP&E. The third category, General PP&E, is divided into two sub-categories, which are: real property (land and buildings) and personal property, which is the focus here.

Personal property is further divided into three categories: capitalized, minor, and sub-minor. Property in any of these categories may be sensitive or classified in nature. All Personal Property requires controls, but the application and extent of the controls are different for each category.

- Capitalized Personal Property: has an acquisition cost equal to or greater than the capitalization threshold established by DoD (currently $100,000 for all capital assets except WCF. $250,000 for WCF as of April 2007[102]), has a useful life of 2 years or more, is not intended for sale in the course of operations, and will be used by DoN. These assets will be reported as assets on the annual financial statements, will be depreciated over time, and will be tracked in the property accounting system.
- Minor Personal Property: has an acquisition cost greater than the accountability threshold (currently $5,000) but less than the capitalization threshold ($100,000), or does not meet all the capitalization criteria. Minor Personal Property items will be expensed on the annual financial statements and will be tracked in the property accounting system.
- Sub-Minor Personal Property: has an acquisition cost of less than the accountability threshold. There are no financial reporting requirements and no mandated accountability requirements except those established at the activity level.

Accounting for Personal Property

An accounting for all capitalized, minor, pilferable, GFE and leased property from the time of receipt through disposal must be maintained in a compliant personal property system approved by DoN. The Defense Property Accountability System (DPAS) has become a standard system for both the Navy and Marine Corps.

All Personal Property receipts must be recorded in DPAS within 7 calendar days and the property must have a tracking bar code applied within 7 calendar days of receipt. The bar code numbers are to be 10 digits in length, with the 5-digit Unit Identification Code (UIC) followed by a unique alphanumeric code assigned by the local activity. Any of these items that have been disposed of shall be removed from DPAS at the time of disposal.

Capitalized items shall be depreciated at the appropriate depreciation rate, upon receipt. The depreciated value of all capitalized assets will be reported on the DoN's annual financial statements. To support this endeavor, major commands are required to compile command financial information and make quarterly

[102] USD(C) memo of 4 Apr 07, Increase to the Defense Working Capital Fund (DWCF) Capital Investment Program (CIP) Capitalization Threshold

financial reports to ASN (FM&C). Readers are directed to SECNAVINST 7320.10A for detailed instructions on computing acquisition costs, recorded costs, cost estimates, depreciation methodology, net estimated residual values, and the like.

Defense Property Accountability System (DPAS)

DoD property accounting has repeatedly been identified as one of DoD's five high-risk areas. The Defense Property Accountability System (DPAS) was directed to be the DoD's single system for property accounting and providing general ledger control. DPAS provides the user with property accountability information and includes all action related to property management, financial accountability, equipment utilization, preventive maintenance schedules, bar code inventory capabilities and warranty information.

Property Control Responsibilities

Each activity commander is required to designate in writing a Personal Property Manager (PPM). The PPM is responsible for management of the activity's Personal Property program, training personnel, coordinating physical inventories and maintaining property system data security and integrity.

Responsible Officers (RO) will be designated, and Responsible Officers are the personnel charged with exercising due care for the personal property assigned to them or for property in the custody of persons reporting to them.

Documentation Requirements

Substantiating documentation is required for all capitalized, minor and pilferable personal property. In addition, the PPM must have a copy of the original site license for all externally developed software. Documentation must be maintained for 36 months after the item(s) is/are disposed of. Documentation requirements are numerous and should be researched in the SECNAVINST 7320 series.

Inventory Requirements

Physical inventories must be accomplished for all Personal Property items maintained in the DPAS. Inventories must compare the DPAS records to the physical assets *and* the physical assets back to the DPAS. Physical inventories will be accomplished at least every three years for capitalized, minor and pilferable personal property; when there is a change in the PPM, ROs or Commander/Commanding Officer; or, as directed. Documentation must include the asset listing, record of adjustments, signatures of persons conducting the inventory and evidence that physical assets were compared to the DPAS and the DPAS was compared to the physical assets. Responsible Officers are responsible for completing the DD Form 200 (Financial Liability Investigation of

Property Loss) for items that are lost, stolen, missing, etc., unless the items are sub-minor property and not pilferable.

Appendix A: Glossary of Terms

This glossary is intended to supplement this text by providing a handy reference. It is by no means comprehensive and there are terms most financial managers will encounter that are not included here. Readers are referred to these other excellent sources:

1. DAU's Defense Acquisition Acronyms and Terms
   http://www.dau.mil/pubscats/Pages/preface.aspx
2. Congressional Budget Office's Glossary of Budget and Economic Terms: http://www.cbo.gov/budget/glossary.shtml
3. U.S. Senate Committee on the Budget, Budget Glossary

   http://budget.senate.gov/republican/major_documents/glossary1.pdf
4. DoD FMR, Volume 2A, Chapter 1, paragraph 010107, page 1-2 through 1.10.

   http://comptroller.defense.gov/fmr/02a/02a_01.pdf
5. GAO, Glossary of Terms Used in the Federal Budget Process

   http://www.gao.gov/new.items/d05734sp.pdf

ACCELERATED LABOR RATE--Labor expense recorded in such a manner that as an employee works one straight time hour, the expense will equal the employee's actual wage plus an "acceleration" percentage to cover the cost of anticipated leave and fringe benefits.

ACCOUNTING CLASSIFICATION--A code used to provide a uniform system of accumulating and reporting information related to public voucher disbursements/refunds.

ACCOUNTS PAYABLE--Amounts due the public or other U.S. Government agencies for material and services received, wages earned, and fringe benefits unpaid. May include amounts billed or billable under contracts for progress payments, earnings of contractors held back, or amounts due upon actual deliveries of goods and services.

ACCOUNTS RECEIVABLE--Amounts due from debtors on open accounts. Under appropriated funds, amounts due from debtors for reimbursements earned or for appropriation refunds due.

ACCRUAL BASIS OF ACCOUNTING--A method of accounting in which revenues are recognized in the period earned and costs are recognized in the period incurred, regardless of when payment is received or made.

ACTIVITY GROUP/SUBACTIVITY GROUP (AG/SAG)--Basic purpose for which an activity proposes to spend money (i.e., Operating Forces).

ADMINISTERING OFFICE--The office, bureau, systems command, or Headquarters, U.S. Marine Corps assigned responsibility for budgeting, accounting, reporting, and controlling obligations and assigned expenditures for programs financed under appropriation(s) or subdivisions of an appropriation. The "Responsible Office" assigns the responsibility.

ADMINISTRATIVE LIMITATION--A limitation imposed within an administrative agency upon the use of an appropriation or other fund having the same effect as a fund subdivision in the control of obligations and expenditures.

AGENCY--Any department, office, commission, authority, administration, board, Government-owned corporation, or other independent establishment of any branch of the Government of the United States.

ALLOCATION--An authorization by a designated official of a component of the Department of Defense making funds available within a prescribed amount to an operating agency for the purpose of making allotments (i.e., the first subdivision of an apportionment). The allocation process ensures Congressional intent is met at levels below the appropriation level.

ALLOTMENT--The authority, expressed in terms of a specific amount of funds, granted by competent authority to commit, obligate and expend funds for a particular purpose. Obligation and expenditure of the funds may not exceed the amount specified in the allotment, and the purpose for which the authorization is made must be adhered to. Allotments are granted for all appropriations except the operating accounts, such as O&M,N and RDT&E,N which use operating budgets.

ANNUAL/ONE YEAR APPROPRIATION--An appropriation available for incurring obligations only during the fiscal year specified in the Appropriation Act.

ANTI-DEFICIENCY ACT, 31 UNITED STATES CODE 1341, 49-50; 1512-14, 17-19 (formerly part of Section 3679, Revised Statutes)--The salient features of this Act include:

- ✓ Making or authorizing an expenditure from, or creating or authorizing an obligation under, any appropriation in excess of the amount available in the appropriation or fund;
- ✓ making obligations or expenditures in excess of an apportionment, or in excess of the amount permitted by agency regulations;

- ✓ involving the government in any contract or other obligation in advance of appropriations;
- ✓ accepting voluntary services for the United States, or employing personal services in excess of that authorized by law

APPEAL--This is an alternate term for reclama; usually used in communications with congressional committees and not used at the installation level.

APPORTIONMENT--A determination made by the Office of Management and Budget which limits the amount of obligations or expenditures which may be incurred during a specified time period. An apportionment may limit all obligations to be incurred during the specified period or it may limit obligations to be incurred for a specific activity, function, project, object, or a combination thereof. Apportionment is designed to limit the number of supplemental and deficiency appropriations.

APPROPRIATION--A part of an appropriations act providing a specific amount of funds to be used for designated purposes. Appropriations are divided into budget activities and further divided into sub-activities, programs, projects or elements of expense, depending on the type of appropriation.

APPROPRIATIONS ACT--An act under the jurisdiction of an appropriations committee, which provides funds for federal programs. There are 13 regular appropriations acts. Congress also passes supplemental appropriations acts when required.

APPROPRIATION LIMITATION--A statutory limitation within an appropriation that cannot be exceeded by incurring obligations or expenditures.

APPROVED PROGRAMS--Resources or data reflected in the latest Future Years Defense Program (FYDP).

ASSETS--Anything owned having monetary value. Property, both real and personal, including notes, accounts, and accrued earnings or revenue receivable; and cash or its equivalent.

AUDIT--The systematic examination of records and documents to determine:

- Adequacy and effectiveness of budgeting, accounting, financial and related policies and procedures;
- Compliance with applicable statutes, regulations, policies and prescribed procedures;
- Reliability, accuracy and completeness of financial and administrative records and reports; and
- The extent to which funds and other resources are properly protected and effectively used.

AUTHORIZATION--Basic substantive legislation enacted by Congress that sets up or continues the legal operation of a federal program or agency. Such legislation is normally a prerequisite for subsequent appropriations, but does not provide budget authority.

AUTHORIZATION ACCOUNTING ACTIVITY--A Navy term representing an activity designated by DFAS to perform accounting for another activity. Also formerly known as an Operating Location, or OPLOC (a DFAS site).

BALANCED BUDGET -A budget in which receipts are equal to outlays.

BASE YEAR--Fiscal year basis of cost estimates.

BUDGET--A plan of operations for a fiscal period in terms of:
- Estimated costs, obligations and expenditures;
- Source of funds for financing including anticipated reimbursements and other resources; and
- History and workload data for the projected programs and activities.

BUDGET AMENDMENT--A proposal that has been submitted to the Congress by the President after his formal budget transmittal, but prior to the completion of appropriation action by the Congress, which revises his previous budget request.

BUDGET AUTHORITY- Authority provided by law to enter into obligations which generally result in immediate or future outlays of Government funds. The basic forms of budget authority are:
- Appropriations,
- Contract authority and
- Borrowing authority.

BUDGET CALL--Budget planning guidance provided from higher authority, down the chain of command.

BUDGET DEFICIT--The amount by which the Government's budget outlays exceed its budget receipts for any given period. Deficits are primarily financed by borrowing from the public.

BUDGET EXECUTION--The accomplishment of the plan prepared during budget formulation. It is the process established to achieve the most effective, efficient and economical use of financial resources in carrying out the program for which the funds were approved.

BUDGET FORMULATION--A process that incorporates those actions performed in the development, review, justification and presentation of budget estimates.

BUDGET PROJECTS--Commodity groups for navy working capital stock fund material.

BUDGET REQUEST--The actual budget that is submitted up the chain of command.

BUDGET SURPLUS (+) OR **DEFICIT** (-)--The difference between budget receipts and outlays.

BUDGET YEAR--The year following the current fiscal year for which the budget estimate is prepared. For example, if the current fiscal year is Fiscal Year 2002, the budget year would be Fiscal Year 2003.

CEILING--A maximum amount of an appropriation imposed by Congress which is designated for a specific purpose, (e.g., travel funding).

CIVIL SERVICE--The term commonly used to describe service performed for the federal government by employed civilians who have competitively attained their positions and who may gain tenure by continuing satisfactory performance.

CLOSED APPROPRIATION ACCOUNT--An appropriation account, the balance of which has been transferred to the Treasury. The appropriation recorded in the account is lapsed.

COMMITMENT--A firm administrative reservation of funds based upon firm procurement directives, orders, requisitions, authorizations to issue travel orders, or requests which authorize the recipient to create obligations without further recourse to the official responsible for certifying the availability of funds. The act of entering into a commitment is usually the first step in the process of spending available funds. The effect of entering into a commitment and the recording of that commitment on the records of the allotment is to reserve funds for future obligations. A commitment is subject to cancellation by the approval authority if it is not already obligated. Commitments are not required under O&M appropriations.

COMMON SERVICE--Non-reimbursable service that has been directed or agreed upon between or among DoD components at the department level.

COMMON USE FACILITY--A building or structure in which both supplier and receiver use space concurrently.

CONGRESSIONAL BUDGET--The budget as set forth by Congress in a concurrent resolution on the budget. These resolutions include:

- The appropriate level of total budget outlays and total new budget authority;
- An estimate of budget outlays and new budget authority for each major functional category; for contingencies, and for other categories;

- The amount of the surplus or deficit in the budget (if any);
- The recommended level of federal revenues; and
- The appropriate level of the public debt.

CONSIGNMENTS (PREVIOUSLY UNFILLED REQUISITIONS)--The Request for Contractual Procurement (NAVCOMPT Form 2276) which does not obligate the requester's funds until the copy of the procurement document is received.

CONTINUING OR NO-YEAR APPROPRIATION--An appropriation that is available to incur obligations for an indefinite period of time. Revolving funds are included in this classification.

CONTINUING RESOLUTION ATHORITY--Congressional action to provide budget authority for specific ongoing activities when the regular fiscal year Appropriations Act has not been enacted by the beginning of the fiscal year. The continuing resolution usually specifies a maximum rate at which the agency may incur obligations and is sometimes based on the rate of spending of the prior year.

CONTROL NUMBERS--Planning limits provided by a major command or a local comptroller to a subordinate activity or department, providing an estimate of the next year's resources.

COST ACCOUNT--Accounts established to classify transactions, according to the purpose of the transactions. Cost account codes are also used to identify uniformly the contents of management reports.

COST ACCOUNT CODES (CAC)--An accounting classification which states specific aspects of functions (i.e., Purchased Electricity [8350]).

COST ACCOUNTING--An accounting system that provides information as to who has spent resources and for what purpose.

COST-BASED BUDGET--A budget based on the cost of goods and services actually to be received during a given period whether paid for before the end of the period or not. Not to be confused with an expenditure-based budget, which is based on the cost of goods and services received and actually paid for.

COST CENTER--A cost center is a subdivision of a field activity or a responsibility center. An individual cost center is a group of homogenous service functions, processes, machines, product lines, professional and/or technical skills, etc. It is an organizational entity for which identification of costs is desired and which is amenable to cost control through one responsible supervisor.

CROSS SERVICING--Support performed by one activity for which reimbursement is required from the activity receiving the support.

CURRENT YEAR--The fiscal year in progress. (See also "Budget Year.")

DEFENSE BUSINESS OPERATIONS FUND--Combined existing commercial and business operations previously managed as individual revolving funds, plus other business areas, into a single revolving business management fund. Now called Defense Working Capital Funds (DWCF).

DEFERRAL OF BUDGET AUTHORITY--An action of the President that temporarily withholds, delays or precludes the obligation or expenditure of budget authority. A deferral must be reported by the President to Congress in a deferral message. The deferral can be overturned if either house passes a resolution that disapproves it. A deferral may not extend beyond the end of the fiscal year in which the message reporting it is transmitted to Congress.

DEFICIENCY APPROPRIATION--An act passed after a fiscal year has expired, to increase funds available such that the appropriation will have a positive balance.

DEOBLIGATION--A downward adjustment of previously recorded obligations. This may be attributable to cancellation of a project or contract, price revisions or corrections of accounts previously recorded as obligations.

DIRECT COSTS--Direct costs are costs incurred directly for and are readily identifiable to specific work or work assignment.

DISBURSEMENT--A term used to describe the actual payment of funds from the U.S. Treasury.

ECONOMY ACT ORDER--An order executed for materials, work or services to be furnished by one activity for another under the authority and limitations of the Economy Act (31 U.S. Code 1535).

EXECUTION--The operation of carrying out a program as contained in the approved budget. It is often referred to as "Budget Execution."

EXPENDITURE--An accounting term used to describe the satisfaction of an obligation; either through the transfer of funds (i.e., O&M,N to WCF) or the disbursement of funds from the U.S. Treasury.

EXPENDITURE AVAILABILITY PERIOD--The expenditure availability period begins upon completion of the obligation availability period. It lasts five years during which the accounting records must be maintained and no new obligations may be created.

EXPENSES--Costs of operation and maintenance of activities on the accrual accounting basis. Expenses include but are not limited to the cost of:

- Civilian personnel services;
- Military personnel services;
- Supplies and material consumed or applied;
- Travel and transportation of personnel;
- Rental of facilities and equipment;
- Minor construction costs less than $750,000 (APF)
- Equipment (having a value of less than $100,000) and
- Services received (purchased utilities, leased communications, printing and reproduction, and other).

EXPENSE ELEMENT--An expense element identifies the type of resource being consumed in the functional/sub-functional category or program element.

EXPENSE LIMITATION--The financial authority issued by a command to an intermediate level of command is an expense limitation. Amounts therein are available for issuance of operating budgets to responsibility centers.

EXPENSE TYPE APPROPRIATIONS--Appropriations that finance the cost of ongoing operations. Within DoD they are normally broken down into two main subcategories: Operations & Maintenance, and Military Personnel.

EXPIRED APPROPRIATION--An appropriation that is no longer available for obligation but is still available for disbursement to liquidate existing obligation.

FENCES--Explicit limitations (ceilings and floors) on the uses of funds that are provided in the funding authorization document. Funds usually can not be transferred or reprogrammed once identified for a specific use.

FISCAL YEAR (FY)--Accounting period beginning on 1 October and ending by 30 September of the following year. The fiscal year is designated by the calendar year in which it ends. Fiscal Year 2002 began on 1 October 2001 and ends 30 September 2002.

FISCAL POLICY--Federal policies on taxes, spending and debt management, intended to promote the nation's goals, particularly with respect to employment, gross national product, inflation and balance of payments. The budget process is a major vehicle for determining and implementing fiscal policy.

FIXED PRICE (FP)--A dollar amount upon which two government activities agree that a service will cost. Once agreed, the service must be provided by the servicing activity at that price regardless of what it costs the servicing activity to perform the service. The purpose of such pricing is to reduce accounting costs. Such prices should not be based upon "ball park estimated," only upon knowledge of the total job. A form of fixed price is a unit rate per hour, day or month charged for Materials Handling Equipment (MHE) or service. Such unit rates are computed at least semi-annually upon a basis of actual cost. It may be a Reimbursable Work Order (RWO) accepted for a stated amount to be billed upon completion of the RWO. Expenses incurred in excess of, or for less than, the agreed amount will constitute a gain or loss to the performing Expense Operating Budget.

FLOOR--A minimum amount of funding that is designated for a specific purpose, (e.g., Maintenance of Real Property).

FRINGE BENEFITS (FRINGE)--The cost of the government's share of a civilian employees': retirement, life insurance, health insurance, social security, and thrift savings plans. Fringe benefits are recovered using an accelerated labor rate for reimbursable work.

FUNCTIONAL CLASSIFICATION--A system of classifying budget resources by major purpose so that budget authority, outlays and credit activities can be related in terms of the national needs being addressed (e.g., national defense, health) regardless of the agency administering the program. A function may be divided into two or more sub-functions, depending upon the complexity of the national need addressed by that function.

FUNCTIONAL MANAGER--A person (manager) responsible for a specific area, such Financial Inventory, Stock Material Sales, Housing and Utility Costs, Flying Hour Costs, Ship Overhaul, Steaming Hour Reports, etc.

FUNCTIONAL/SUB-FUNCTIONAL CATEGORY (F/SFC)--Sub-functional categories are a finer grouping within the functional category grouping. They are used to accumulate expenses separately for various functions encompassed by a single functional category. Combined they provide a classification which states what functions will be performed (e.g., Administration).

FUND AVAILABILITY--The amount of obligation authority in a fund or fund subdivision.

FUND SUBDIVISION--A segment of an appropriation or other fund, created by funding action as an administrative means of controlling obligations and expenditures within an agency.

FUNDED REIMBURSEMENT--A reimbursement in which the performing activity receives a written order.

FUTURE YEARS DEFENSE PROGRAM (FYDP)--The FYDP summarizes all approved programs of the entire Department of Defense. Resources or inputs required for six years are combined with military outputs of programs for the same period. The FYDP is expressed in terms of TOA (dollars), manpower (civilian FTE and military) and forces (equipment such as tanks, planes, etc.).

GENERAL EXPENSES--Costs incurred by general cost centers which are not incurred for, and are not readily identifiable with, specific direct job orders and which are not included in the indirect expense of the direct cost centers.

GENERAL LEDGER--The general ledger is the book of accounts in which all accounting entries are ultimately summarized. It is maintained by an authorization accounting activity for each operating budget/allotment holder. It is designed so that summary reports of all financial transactions can be readily prepared for management.

GROSS ADJUSTED OBLIGATIONS--The sum of all liquidated and unliquidated obligations.

GROSS DISBURSEMENTS--Represents the amount of checks issued, cash or other payments made, less funds received.

HOST ACTIVITY--This is an activity that provides facilities to another activity and may supply its services.

IMPOUNDMENT--See Deferral of Budget Authority

IMPREST FUND--Fixed amount of cash used to make minor expenditures for local commercial purposes. Payments from the fund are reimbursed from time to time to maintain a fixed amount in the fund.

INCREMENTAL FUNDING--The provision (or recording) of budgetary resources for a program or project based on obligations estimated to be incurred within a fiscal year when such budgetary resources will cover only a portion of the obligations to be incurred in completing the program or projects as programmed. This differs from full funding, where budgetary resources are provided or recorded for the total estimated obligations for a program or project in the initial year of funding. Annual appropriations are incrementally funded.

INDIRECT COSTS—Indirect costs are those mission costs that can't be identified to a single output. They are allocated over a select number of outputs.

INDIRECT EXPENSE--Indirect expenses are costs incurred by direct cost centers, which are not incurred directly for and are not readily identifiable with specific job orders established for the accomplishment of assigned work.

INDUSTRIAL PLANT EQUIPMENT--Equipment with a value of at least $100,000 and useful life of 2 years or more, that cuts, abrades, bends or otherwise reshapes or reforms materials.

INPUT BUDGETING--A budgetary method that focuses on the cost of the objects or inputs.

INTERNAL AUDIT--The independent appraisal activity within an organization that reviews the accounting, financial and related operations as a basis for protective and constructive services to management.

INTERSERVICE SUPPORT--Action on the part of one activity to provide support to another activity within the same DoD component or other federal agency.

INTRAGOVERNMENTAL SUPPORT--Support provided by one Federal Agency or subdivision thereof to another Federal Agency or subdivision thereof.

INVESTMENT-TYPE APPROPRIATIONS--Appropriations for investment type items as opposed to ongoing operations. The investment category is essentially split into two areas: procurement and military construction.

INVOICE--This term includes contractor requests for payment, travel claims and other miscellaneous vouchers.

INVOICE CERTIFICATION--Invoice certification (also called receipt certification) is a statement placed on an invoice, or a receiving document related to an invoice, certifying that the goods or services were received and accepted.

ISSUE PAPER—Preliminary or final decision by line item indicating a change (usually a decrease) in a budget request. Formerly referred to as a MARK.

JOB ORDER--Two definitions are used:

- A formal instruction to perform certain work according to specifications, estimates, etc.;
- Descriptive of a cost system whereby costs are accumulated by job orders.

JOINT USE FACILITY--A separate building or structure that is occupied jointly, when specific space has been designated for the sole use of each of the occupants.

LABOR DISTRIBUTION--The vehicle that transfers the actual cost of labor to the job order cost accounting system.

LABOR DISTRIBUTION CARD--A card that identifies hours spent day by day for each job order applicable to their effort.

LAPSED APPROPRIATION--An appropriation whose undisbursed balance is no longer available for disbursement as the five-year expenditure availability period has ended. This is also known as a closed or canceled appropriation.

LIABILITIES--Amounts of money owed to others for goods and services received, or for assets acquired. Liabilities include accrued amounts earned but not yet due for payment, and progress payments due to contractors.

LIMITATION--A statutory restriction within an appropriation or other authorization or fund that establishes the maximum amount that may be used for specific purposes.

LIQUIDATED OBLIGATION--An obligation that is matched with a matching expenditure.

MAJOR COMMAND/SUBCOMMAND--A major command is a bureau, office, or Headquarters that is designated as an administering office under the Operation and Maintenance appropriations in NAVSO P-1000. Navy major commands receive operating budgets directly from the Chief of Naval Operations Fiscal Management Division (N-82). Subcommands are bureaus/offices/commands designated as administering offices that receive a subcommand operating budget from a major command.

MANAGEMENT CONTROL--Management control consists of internal checks established to safeguard property and funds; to check accuracy, reliability and timeliness of accounting data to promote operational efficiency; and to ensure adherence to prescribed management policies and procedures.

MARK--Decision by line item indicating a change (usually a decrease) in a budget request. Now referred to as an Issue Paper.

MEMORANDUM ACCOUNT--An account, usually stated in financial terms, but not always a part of the basic double-entry system of accounts, used for obtaining data required for control, reporting or other purposes.

MIDYEAR REVIEW OF THE BUDGET--A locally conducted review to determine the adequacy of present funding levels, to update unfunded requirements to the next level in the financial chain-of-command and to update the budget submission being prepared for delivery to Congress.

MILSTRIP/MILSTRAP--The Military Standard Requisitioning and Issue Procedures (MILSTRIP) system provides a standardized language of codes and coding techniques and a standard set of forms for requisitioning and issue transactions. The Military Standard Transaction Reporting and accounting Procedures (MILSTRAP) system provides uniform procedures, codes and documents for use in transmitting receipt, issue and adjustment data between inventory managers and stock points in support of supply and financial management.

MINOR NEW CONSTRUCTION--Describes construction costing from $1 to $1,500,000; however, construction projects costing greater than $750,000 can only be processed as Minor Construction if so urgently required that authorization and funding cannot possibly be delayed for a regular Military Construction (MILCON) program. The Navy Operations and Maintenance appropriation may fund projects costing $1 to $750,000.

MINOR PERSONAL PROPERTY--Navy personal property acquired for immediate use and having a unit cost of $5,000 to less than $100,000, or a cost of greater than $100,000 but with a useful life of less than 2 years.

MULTI-YEAR APPROPRIATIONS--Appropriations available for incurring obligations for a definite period that is in excess of one fiscal year.

NEW OBLIGATIONAL AUTHORITY (NOA)--This term has been replaced by Budget Authority. However, it is sometimes used to indicate budget authority newly enacted in an appropriation (as distinguished from transfer of Budget Authority).

NONAPPROPRIATED FUNDS--Monies derived from sources other than Congressional Appropriations, primarily from the sale of goods and services to DoD military and civilian personnel and their dependents and used to support or provide essential morale, welfare, recreational and certain religious and education programs. Another distinguishing characteristic of these funds is the fact that there is no accountability for them in the fiscal records of the Treasury of the United States.

NO-YEAR APPROPRIATION--See Continuing Appropriation.

OBJECT CLASSIFICATION--A uniform classification identifying the transactions of the federal government by the nature of the goods or services purchased (e.g., personnel compensation, supplies and materials, equipment) without regard to the agency involved or the purpose of the programs for which they are used.

OBLIGATION--A duty to make a future payment of money. The duty is incurred as soon as an order is placed, or a contract is awarded for the delivery of goods and the performance of services. It is not necessary that goods actually be delivered, or services actually are performed, before the obligation is created; neither is it necessary that a bill, or invoice, be received first. The placement of an order is sufficient. An obligation legally encumbers a specified sum of money that will require outlay(s) or expenditure(s) in the future.

OBLIGATION AVAILABILITY PERIOD--Appropriations have a specific obligation availability period or duration that can be grouped as either annual or multi-year. Generally, the duration of this period is consistent with the funding characteristics of the appropriation.

OBLIGATIONAL ACCOUNTING--A method of keeping track of the cumulative total of resources for which authority to spend has been passed for a particular fiscal year.

OBLIGATIONAL AUTHORITY--Three definitions may apply:

- An authorization by Act of Congress to procure goods and services within a specified amount by appropriation or other authorization.
- The administrative extension of such authority as by apportionment or funding.
- The amount of authority so granted.

OFFICE OF MANAGEMENT AND BUDGET (OMB)--Established as the Bureau of Budget by the Budget and Accounting Act of 1921 and renamed in 1970. Major functions include assisting the President in budget preparation and fiscal program formulation; supervision and control of budget administration; and increasing efficiency and economy of government service.

OFFSETTING COLLECTIONS--Moneys received by the government as a result of business-type transactions with the public (sale of goods and services) or as a result of a payment from one government account to another. Such collections are netted in determining budget outlays.

OFFSETTING RECEIPTS--All collections deposited into receipt accounts that are offset against budget authority and outlays rather than reflected as budget receipts in computing budget totals. Under current budgetary usage, cash collections not deposited into receipt accounts (such as revolving fund receipts and reimbursements) are deducted from outlays at the account level. These transactions are offsetting collections but are not classified as "offsetting receipts."

OPEN APPROPRIATION ACCOUNT--An appropriation account, the balance of which has not been returned to the Treasury general fund. The appropriation recorded in the account may be unexpired or expired.

OPERATING AND SUPPORT COSTS--Those recurring costs associated with operating, modifying, maintaining, supplying and supporting a weapon/support system in the DoD inventory.

OPERATING BUDGET (OB)--An operating budget is the annual budget of an activity stated in terms of subactivity group codes, functional/sub-functional categories and cost accounts. It contains estimates of the total value of resources required for the performance of the mission including reimbursable work or services for others. It also includes estimates of workload in terms of total work units identified by cost accounts.

OPERATING BUDGET PLAN--An estimate of monetary needs for a fiscal year, developed by cost center managers and the activity comptroller by accounting group and sub-accounting group.

OPERATING TARGET (OPTAR)-A planning estimate rather than legal limitation on expenditures provided to an afloat operating unit or department ashore.

OPERATION AND MAINTENANCE, NAVY (O&M,N)--An appropriation intended to finance the basic day-to-day operation of the fleet and principal shore activities of the Navy, issued to Operating Budget (OB) holders for normal expenses incurred in operating and maintaining an activity.

ORDERING ACTIVITY--An activity that originates a requisition or order for procurement, production, or performance of work or services by another activity.

OTHER PROCUREMENT, NAVY (OPN)--An appropriation of funds established for the financing of systems, equipment and related support meeting the investment criteria.

OUTLAYS--A budget term used to describe an actual cash payment or issuance of a check against the Treasury to satisfy a government obligation. Outlays include interest accrued on the public debt or other forms of payment, net of refunds and reimbursements. Outlays are also called expenditures or net disbursements.

PAST YEAR--The fiscal year immediately proceeding the current year, the last completed fiscal year.

PERFORMANCE BUDGET--A budget that focuses attention upon the general character and relative importance of the work to be done by taking as its basis the estimated cost of programs, function, and project designed to accomplish mission. For example, the cost of a function: e.g., operating a rifle range, communications centers, motor pool, etc.; versus the cost of "things"; e.g., supplies, equipment, personnel services, etc.

PERFORMING ACTIVITY--An activity that is responsible for performing work or services, including production of material and/or procurement of goods and services from other contractors and activities.

PLANNING ESTIMATE/OPERATING TARGET (OPTAR) HOLDER--A planning estimate/OPTAR Holder is a person granted administrative control of a designated amount of funds. Planning estimates/OPTAR's are issued by operating budget holders to departments, divisions, etc., within a responsibility center.

PLANNING, PROGRAMMING, and BUDGETING SYSTEM (PPBE)--An integrated system for the establishment, maintenance and revision of the FYDP and the DoD budget.

PLANT PROPERTY--DoD owned/controlled real and personal property of a capital nature located in the naval shore establishment.

PRESIDENT'S BUDGET--The budget for a particular fiscal year transmitted to the Congress by the President in accordance with the Budget and Accounting Act of 1921, as amended.

PRINCIPAL ITEMS--A relatively small number of very high cost major end-items that are procured through investment appropriations and normally managed by a hardware command. Principal items are normally issued to Navy end users without charge.

PROGRAM--A combination of program elements designed to express the accomplishment of a definite objective or plan which is specified as to the time phasing of what is to be done and the means proposed for its accomplishment. Programs are aggregations of program elements and, in turn, aggregate to the total FYDP.

PROGRAM COST CATEGORIES--

- **Research and Development**. Those program costs primarily associated with Research and Development efforts including the development of a new or improved capability to the point where it is ready for operational use. These costs include equipment costs funded under the RDT&E appropriations and related Military Construction appropriation costs. They exclude costs that appear in the Military Personnel, Operation and Maintenance and Procurement appropriations.
- **Investment**. Those program costs required beyond the development phase to introduce into operational use a new capability, to procure initial, additional or replacement equipment for operational forces or to provide for major modifications of an existing capability. They include Procurement and Military Construction appropriation costs, and exclude RDT&E, Military Personnel, and Operation and Maintenance appropriation costs.
    - **Operating**. Those program costs necessary to operate and maintain the capability. These costs include Military Personnel and Operations and Maintenance.

PROGRAM DECISION MEMORANDUM (PDM)--A document which provides decisions of the Secretary of Defense on Military Department POMs.

PROGRAM ELEMENT--A description of a mission by the identification of the organizational entities and resources needed to perform the assigned mission. Resources consist of forces, manpower, and equipment, as applicable. The Program Element is the basic building block for the FYDP.

PROGRAM OBJECTIVES MEMORANDUM (POM)--A formal submission from the Military Departments to the Secretary of Defense in a prescribed format which outlines the resource allocation decisions made by the Military Departments in accordance with the Defense Planning Guidance.

PROGRAMMING COST--Cost data for making program decisions. Programming costs are based on sets of factors that will provide consistent cost data under the same or similar circumstances and which are directly related to the explicit elements of the program decision.

PROJECT--A planned undertaking having a finite beginning and ending, involving definition, development, production and logistic support of a major weapon or weapon support system or systems. A project may be the whole or part of a program. A Designated Project is a project that, because of its importance or critical nature, has been selected for intensified project management.

PROJECT MANAGER--The individual within the bureaus, and offices responsible, within well-defined boundaries of time, resources, and performance requirements, for executing an approved project.

PROJECT ORDER--A specific, definite and certain order between DoD activities, for work or for the manufacture of supplies, material or equipment that, for the purpose of obligation assumes the characteristics of orders or contracts placed with commercial enterprises.

PROMPT PAYMENTACT--Legislation that requires the Federal Government to pay interest on late payments made on contracts and purchase orders.

REAPPORTIONMENT--A revision of an annual "apportionment" during the fiscal year, either upward or downward.

REAPPROPRIATION--Congressional action to restore the obligation availability, whether for the same or different purposes, of all or part of the unobligated portion of budget authority in an expired account. Obligation availability in a current account may also be extended by a subsequent appropriation act.

RECEIVABLES--A collective term used to describe amounts due or to become due from others, usually within a relatively short time.

RECLAMA--A request for reconsideration of an item that has been deleted, reduced or otherwise adjusted during the FMB and OSD/OMB phases of the budget process. Although the term "Appeal" has the same meaning, it is <u>not normally used</u> in connection with these phases.

RECONCILIATION--A process use by Congress to reconcile amounts determined by tax, spending, and debt legislation for a given fiscal year with the ceilings enacted in the concurrent resolution on the budget for that year.

REFUNDS--Recoveries of excess payments that are for credit to an appropriation or fund account. These items, such as the recovery of a salary overpayment or a return of the unused portion of a travel advance, will not be included as reimbursements but will be treated as reductions of disbursements. Refunds will also include credits to an appropriation or fund account due to accounting adjustment relating to obligations or disbursements where such procedure is permitted by law or regulations.

REIMBURSABLE EXPENDITURE--An expenditure that is made for another agency, fund, or appropriation, or for a private individual, firm or corporation, which subsequently will be recovered.

REIMBURSABLE OPTAR--Funds provided by a tenant to a host command in return for the host's providing specified and mutually agreed services.

REIMBURSABLE WORK ORDER (RWO)--A request to provide a product or service which may entail expenditure of labor, material, services or sub-contractual support to fulfill the request, and with funds coming from outside the Operating Budget.

REIMBURSEMENTS--Amounts received by an activity for the cost of material, work, or services furnished to others, for credit to an appropriation or other fund account.

REPROGRAMMING--The transfer of funds between programs of an appropriation; a shifting of funds from the original purpose for which they were justified by Congress.

REQUEST FOR CONTRACTUAL PROCUREMENT—A request normally used to provide funds for direct citation on contracts or requisitions. These citations are of the requester's fund vice those of the performing contracting activity.

RESCISSION BILL--A bill or joint resolution that provides for cancellation, in whole or in part, of budget authority previously granted by the Congress. Under the Impoundment Control Act of 1974, unless Congress approves a rescission bill within 45 days of continuous session after receipt of the proposal, the budget authority must be made available for obligation.

RESOURCE AUTHORIZATION--Title of the Funding Document NAVCOMPT 2168-1, NAVCOMPT 372, etc., authorizing Obligation and/or Expense/Military Services Authority (funds).

RESOURCE MANAGEMENT SYSTEM (RMS)--The formalized system by which the DoD tracks and accounts for financial resources provided to and employed by ashore commands within the Operations and Maintenance (O&M) and Research and Development Appropriations (RDT&E).

RESOURCES--Resources consist of military and civilian personnel, material on hand and on order, and the entitlement to procure or use material, utilities and services.

RESPONSIBLE OFFICE--The office, bureau, systems command, or Headquarters, U.S. Marine Corps which has been assigned the responsibility for overall management for all programs financed by an appropriation. The Director, CNO Fiscal Management Division (N-82) is the responsible office for all Navy appropriations, except RDT&E,N appropriation. The Headquarters, U.S. Marine Corps is the responsible office of all Marine Corps appropriations. The Office of the Chief of Naval Research is the responsible office for RDT&E,N.

RESPONSIBILITY CENTER--An activity listed in the Standard Navy Distribution List. Several activities may be combined in one responsibility center when the individual activities are considered small enough to justify the combination or when operational requirements make the combination necessary.

REVENUES--Receipts collected by the federal government as duties, taxes or as premiums from social insurance programs.

REVOLVING FUND--A fund established to finance a cycle of operations in which reimbursements and collections were returned for reuse in a manner that maintained the principal of the fund. A self-perpetuating or working capital fund. See Defense Business Operations Fund (DBOF).

SEQUESTRATION--An automatic, across-the-board (less exempted categories) reduction of funds that can occur if spending exceeds the caps on "discretionary spending" in accordance with the Budget Enforcement Act of 1990

SERVICES REQUEST--An order for services to be performed issued by an activity, organization or private party to another. Documents utilized for this purpose are ordered for Work and Services (NAVCOMPT Form 2275), Requisition (DD Form 1348), and Request for Issue or Turn-in (DD Form 1150). The accepted order is the basic source of authority to incur costs and perform work.

SOLE USE FACILITY--A building or structure that is designated for the exclusive use of the receiver. Identifiable costs are reimbursable.

SPECIFIC JOB ORDER--A job order established for the accomplishment of specified work with an estimated completion date and for which summarization of cost incurred is desired upon completion.

SPENDING PLAN-A responsibility center's documented budget execution plan detailing how it intends to spend that fiscal year's funds.

STABILIZED RATES-- Predetermined rates for billing customers for work to be accomplished by WCF activities.

STANDARD DOCUMENT NUMBER--A 15-character alphanumeric code assigned to each document prepared and processed as inputs to the financial system. The first six positions represent the unit identification code (UIC) of the issuing activity.

STANDING JOB ORDER--A job order established to provide for services in connection with the maintenance and operation of the activity during a specified period.

SUBHEAD--A four digit numerical or alphanumeric character identifying the first level subdivision of an appropriation used primarily for administration, accounting and control of an appropriation.

SUCCESSOR "M" ACCOUNT--Previously, upon lapse of annual and multiple-year appropriations, the obligated but unexpended balances merged/transferred into the appropriations Successor "M" Account. The "M" Account was phased out on 30 September 1993.

SUPPLEMENTAL APPROPRIATION--An appropriation enacted as an addition to a regular annual appropriation act. Supplemental appropriations provide additional budget authority beyond original estimates for programs or activities that are too urgent to be postponed until the next regular appropriation.

SUPPORTING ACTIVITY--This is an activity that provides only services to another activity.

SURPLUS--The amount by which revenues exceed outlays.

TENANT ACTIVITY--An activity that uses facilities and receives support from another activity.

TOTAL OBLIGATIONAL AUTHORITY (TOA)--TOA is the total amount of funds available for programming in a given year, regardless if the year the funds are appropriated, obligated, or expended. TOA includes new obligation authority, unprogrammed or reprogrammed obligation authority from prior years, reimbursements not used for replacement of inventory in kind, advance funding for programs to be financed in the future and unobligated balances transferred from other appropriations.

TRANSACTION (FINANCIAL)--The conduct of business involving the participation of two or more parties for the purpose of exchange of goods or services for money or other considerations. A transaction is comprised of various stages before completion. The function of an accounting system is to identify, classify and record transactions.

TRANSFER AUTHORITY--Authority provided by Congress to move budget authority from one appropriation or working capital fund or any statutory subdivision thereof, to another.

UNDELIVERED ORDERS--An undelivered order is any document, meeting the criteria for an obligation that is issued for material or services that has not as yet been received by the activity that ordered it.   Includes material requisitions applicable to reimbursable orders issued for material to be delivered from a stock funded inventory, purchase orders issued which cite annual appropriations and overhead materials requisitions issued by modified industrial activities whose operations are principally financed by reimbursable orders.

UNDISTRIBUTED DISBURSEMENTS--Disbursements not processed by the authorization accounting activity against obligation records.

UNFUNDED REIMBURSEMENTS--Unfunded reimbursements result when work or services are provided without a specific order. Reimbursement for user charges (i.e., commissary surcharge) and jury duty fees, are examples.

UNFUNDED REQUIREMENTS--Those programs and functions that cannot be performed within the constraints of the control numbers assigned to an activity.

UNIFIED BUDGET--Describes the way the federal budget is currently displayed. This display includes revenues and spending for all regular federal programs and trust funds except Social Security, which was removed from budget totals beginning with Fiscal Year 1987. Prior to the creation of the unified budget in 1969, all trust funds were excluded from budget totals.

UNIT COST--Determined by taking actual total costs divided by actual workload (outputs). The unit cost is based on actual results.

UNIT COST GOAL--Determined by taking total budgeted costs and divide by total budgeted workload (outputs). These goals are issued to activities operating in the Annual Operating Budget (AOB).

UNLIQUIDATED OBLIGATIONS--Outstanding obligations with no matching expenditures.

UNMATCHED DISBURSEMENTS--Disbursements that cannot be matched to existing obligations.

VOUCHER--Any document that is evidence of a transaction, showing the nature and amount of the transaction. It usually indicates the accounts in which the transaction is to be recorded.

VOUCHER NUMBER--A serial number assigned to a voucher used to make payments to a contractor for delivery of supplies or performance of a service.

WARRANT--An official document issued by the Secretary of the Treasury and countersigned by the Comptroller General of the United States by which monies are authorized to be withdrawn from the Treasury. Warrants are issued after appropriations and similar congressional authority have been enacted.

WORK MEASUREMENT--The process of establishing performance standards in terms of hours per work unit. Some of the principal techniques used are: stopwatch observations, synthesis of predetermined standards; work sampling; and statistical inference from historical data. The principal purpose of the standards is to compare the work performed with the man-hours expended. Such information may be used for personnel planning, work scheduling, budget justification and cost control.

WORK UNIT--Work units are measures of output that express volume of work; conversely, man-hours and dollars are measures of input required to produce work units or perform work.

WORKING CAPITAL FUND--A revolving fund used as a source of financing for work that will be paid for by the customer after the completion of the job. Working Capital Funds replaced DBOF in December 1996. See Defense Business Operations Fund.

WORK-IN-PROCESS ACCOUNT--Temporary investment of cost into customer requested work that as yet is unbilled.

YEAR-TO-DATE (YTD)--Cumulative totals lodged against job orders or cost accounts from the beginning of the fiscal year to current date.

Appendix B: Acronyms

AAA	Authorization Accounting Activity
ABS	Amended Budget Submission
ACDUTRA	Active Duty Training
ACO	Administrative Contracting Office
ACRN	Accounting Classification Reference Number
ACWP	Actual Cost of Work Performed
ADO	Associate Disbursing Office
ADP	Automated Data Processing
ADPE	Automated Data Processing Equipment
ADS	Automated Data System
AF	Air Force (for form numbers)
AFRICOM	US Africa Command
AG/SAG	Activity Group/Sub-activity Group
AO	Administering Office
AOB	Annual Operating Budget
AOR	Accumulated Operating Result (WCF)
AOR	Area of Responsibility (COCOMs)
AP	Advanced Procurement
APADE(S)	Automated Procurement and Accounting Data Entry (System)
APAF	Aircraft Procurement, Air Force
APDM	Amended Program Decision Memorandum
APF	Appropriated Funds
APN	Aircraft Procurement, Navy
APPN	Appropriation
APV	Automated Public Voucher
ASD	Assistant Secretary of Defense
ASN	Assistant Secretary of the Navy
ASN (FM&C)	Assistant Secretary of the Navy for Financial Management & Comptroller
ASPR	Armed Services Procurement Regulation
AUOL	Aged Unfilled Orders Listing
AUTODIN	Automatic Digital Network
BA	Budget Activity
BA	Budget Authority
BAC	Budget at Completion
BAM	Baseline Assessment Memorandum
BCN	Bureau Control Number
BCP	Budget Change Proposal
BCWP	Budgeted Cost of Work Performed
BEA	Budget Enforcement Act
BEA	Business Enterprise Architecture
BES	Budget Estimate Submission
BG	Budget Guidance

BMMP	Business Management Modernization Program
BO	Budget Outcome
BOA	Basic Ordering Agreement
BOS	Base Operating Support
BP	Budget Project
BP	Budget Productivity
BPA	Blanket Purchase Agreement
BPI	Budget Productivity Index
BQ	Budget Quality
BRAC	Base Realignment and Closure
BSO	Budget Submitting Office
BT	Budget Unit Timeliness
BUMED	Bureau of Medicine
BUPERS	Bureau of Personnel
BY	Budget Year
C4I	Command, Control, Communications, Computers & Intelligence
CA	Commercial Activity
CAB	Centralized Accounting Billing
CAC	Cost Account Code
CAM	Claimant Accounting Module
CAO	Central Accounts Office
CAPE	Cost Assessment & Program Evaluation
CBA	Centrally Billed Account
CBO	Congressional Budget Office
CDA	Central Design Activity
CDFM-A	Certified Defense Financial Manager with Acquisition
CDO	Central Disbursing Office
CEB	CNO Executive Board
CEI	Civilian Personnel Execution Indicator
CENTCOM	US Central Command
CERPS	Centralized Expenditure Reporting Processing System
CFO	Chief Financial Officer
CFR	Code of Federal Regulation
CGFM	Certified Government Financial Manager
CICA	Competition in Contracting Act
CIM	Corporate Information Management
CJCS	Chairman of the Joint Chiefs of Staff
CMC	Commandant of the Marine Corps
CMD	Command
CNAVRES	Chief of Naval Reserve
CNET	Chief of Naval Education and Training
CNO	Chief of Naval Operations
CNR	Chief of Naval Research
CO	Commanding Officer
COCOM	Combatant Commander

COG	Cognizance Symbol
COGS	Cost of Goods Sold
CONUS	Continental United States
CP	Capability Portfolio
CPA	Certified Public Accountant
CPA	Chairman's Program Assessment
CPAF	Cost Plus Award Fee
CPAM	CNO's Program Analysis Memorandum
CPFF	Cost Plus Fixed Fee
CPIF	Cost Plus Incentive Fee
CPM	Capability Portfolio Manager
CPR	Chairman's Program Recommendation
CPRRS	Civilian Personnel Resource Reporting System
CRA	Continuing Resolution Authority
CRF	Central Reporting Facility
CRS	Congressional Research Office
CSRS	Civil Service Retirement System
CV	Cost Variance
CY	Current Year
D&F	Determination & Findings
DAASO	Defense Automatic Addressing Systems Office
DAB	Defense Acquisition Board
DACC	Defense Accounting Classification Crosswalk
DAPS	Defense Automated Printing Service
DAR	Defense Acquisition Regulation
DAS	Defense Acquisition System
DAWG	Defense Advisory Working Group
DAWIA	Defense Acquisition Workforce Improvement Act
DBOF	Defense Business Operations Fund
DBR	Detail Billing Record
DCAA	Defense Contract Audit Agency
DCASR	Defense Contract Administration Services Region
DCNO	Deputy Chief of Naval Operations
DCPS	Defense Civilian Payroll System
DD	Department of Defense (for form numbers)
DDO	Deputy Disbursing Officer
DERA	Defense Environmental Restoration Account
DFAR	Defense Federal Acquisition Regulation
DFAS	Defense Finance and Accounting Service
DFMC	Defense Financial Management Certification
DJMS	Defense Joint Military Pay System
DLA	Defense Logistics Agency
DLH	Direct Labor Hour
DLR	Depot Level Repairable
DMRD	Defense Management Report Decision
DO	Disbursing Office

DoD	Department of Defense
DODAAC	DoD Activity Address Code
DODADD	DoD Activity Address Directory
DODD	DoD Directive
DODI	DoD Instruction
DODIG	DoD Inspector General
DoL	Department of Labor
DON	Department of the Navy
DONPIC	Department of the Navy Program Information Center
DOV	Disbursing Officer Voucher
DPAS	Defense Property Accountability System
DPPG	Defense Planning & Programming Guidance
DPG	Defense Planning Guidance
DRAS	Defense Retiree and Annuitant Pay System
DRB	Defense Resource Board
DRIS	Defense Regional Interservice Support
DSS	Defense Security Service
DTS	Defense Travel System
DWCF	Defense Working Capital Fund
EAO	Economy Act Order
EAP	Expenditure Availability Period
EE	Expense Element
EFD	Engineering Field Division
EFT	Electronic Funds Transfer
EOB	Expense Operating Budget
EOQ	Economic Ordering Quantity
ERP	Enterprise Resource Planning
EUCOM	US European Command
EVA	Earned Value Analysis
EVM	Earned Value Management
F/SFC	Functional/Subfunctional Category
FAA	Funds Administering Activity
FAR	Federal Acquisition Regulation
FASAB	Financial Accounting Standards Advisory Board
FEA	Front End Assessment
FEC	Facility Engineering Command
FECA	Federal Employee Compensation Act
FEGLI	Federal Employee Group Life Insurance
FEHB	Federal Employee Health Benefits
FEI	Financial Efficiency Index
FEPCA	Federal Employee Pay Comparability Act
FERS	Federal Employees Retirement System
FFC	Fleet Forces Command
FFMIA	Federal Financial Management Improvement Act of 1996
FFP	Firm Fixed Price
FFP	Firm Fixed Price

FHCON	Family Housing Construction
FHCR	Flying Hour Cost Report
FHOP	Family Housing Operations
FICL	Financial Inventory Control Ledgers
FINMIS	Financial Management Information System
FIPC	Financial Information Processing Center
FIPS	Financial Information Processing System
FIR	Financial Inventory Reporting
FISC	Fleet and Industrial Supply Center
FITW	Federal Income Tax Withheld
FLSA	Fair Labor Standards Act
FM	Financial Management
FMB	Financial Management & Budget
FMFIA	Federal Managers' Financial Integrity Act of 1982
FMO	Financial Management Operations
FMR	Financial Management Regulation
FMS	Foreign Military Sales
FMSO	Fleet Material Support Office
FOL	Fact of Life
FPI	Fix Price Incentive
FPR	Federal Procurement Regulation
FRS	Financial Reporting System
FSIO	Financial Systems Integration Office
FTE	Full Time Equivalent
FWS	Federal Wage System
FY	Fiscal Year
FYDP	Future Years Defense Program
FYTD	Fiscal Year to Date
G&A	General and Administrative
GAGAS	Generally Accepted Government Auditing Standards
GAO	Government Accountability Office / Gross Adjusted Obligations
GASB	Governmental Accounting Standards Board
GDP	Gross Domestic Product
GDF	Guidance for Developing the Forces
GEF	Guidance for Employing the Forces
GFE	Government Furnished Equipment
GLA	General Ledger Account
GM	General Manager
GMRA	Government Management Reform Act of 1994
GNP	Gross National Product
GPRA	Government Performance and Results Act of 1993
GS	General Schedule
GSA	General Services Administration
HAC	House Appropriations Committee
HASC	House Armed Services Committee

HQMC	Headquarters, Marine Corps
HRO	Human Resources Office
IBA	Individually Billed Account
IBR	Investment Balance Review
IC	Internal Control
ICP	Integrated Capability Plan
ICP	Inventory Control Point
IFB	Invitation for bid
IIRA	Integrated Infrastructure Requirements Assessment
IPA	Integrated Program Assessment
IPE	Industrial Plant Equipment
IPL	Integrated Priority List
IR^{3}B	Integrated Resources and Requirements Review Board
IRR	Internal Rate of Return
IRS	Internal Revenue Service
ISA	Interservice / Intraservice Support Agreement
ISCP	Integrated Sponsor Capability Plan
ISPP	Integrated Sponsor Program Proposal
ISR	Investment Strategy Review
IWAR	Integrated Warfare Architecture
JCA	Joint Capability Area
JCS	Joint Chiefs of Staff
JFMIP	Joint Financial Management Improvement Program
JMS	Justification Management System
JON	Job Order Number
JOPES	Joint Operational Planning and Execution System
JPAM	Joint Program Assessment Memorandum
JPD	Joint Planning Document
JPG	Joint Programming Guidance
JROC	Joint Requirements Oversight Council
JSPD	Joint Strategic Planning Document
JSPS	Joint Strategic Planning System
JTR	Joint Travel Regulation
LAC	Latest Acquisition Cost
LANTFLT	U.S. Atlantic Fleet
LAS	Ledger Accounting System
LES	Leave and Earnings Statement
LMC	Local Management Code
LOA	Line of Accounting
LRC	Latest Repair Cost
LWOP	Leave Without Pay
MAJCOM	Major Command
MBI	Major Budget Issues
MC	Management Control
MCN	Military Construction, Navy
MCON	Military Construction

MCR	Management Control Review
MEO	Most Efficient Organization
MIC	Manager Internal Control
MID	Management Initiative Decision
MILCON	Military Construction
MIPR	Military Interdepartmental Purchase Request
MOA	Memorandum of Agreement
MOU	Memorandum of Understanding
MPMC	Military Personnel, Marine Corps
MPMCR	Military Personnel, Marine Corps, Reserve
MPN	Military Personnel, Navy
MPT&E	Manpower, Personnel, Training & Education
MRP	Maintenance of Real Property
MTD	Month to Date
MTP	Managing to Payroll
MTS	Metric Tracking System
MWR	Morale, Welfare & Recreation
MYP	Multi-Year Procurement
NAF	Non-appropriated Fund
NAFI	Non-appropriated Fund Instrumentality
NASA	National Aeronautics and Space Administration
NATO	North Atlantic Treaty Organization
NAVAIR	Naval Air Systems Command
NAVAUDSVC	Naval Audit Service
NAVCOMPT	Office of the Comptroller, Navy
NAVFAC	Naval Facilities Engineering Command
NAVSEA	Naval Sea Systems Command
NAVSUP	Naval Supply Systems Command
NC	NAVCOMPT (for form numbers)
NDS	National Defense Strategy
NDSF	Navy Defense Sealift Fund
NHBS	Navy Headquarters Budget System
NMS	National Military Strategy
NOA	New Obligation Authority
NOR	Net Operating Result
NSN	National Stock Number
NSP	Navy Strategic Plan
NSPS	National Security Personnel System
NSS	National Security Strategy
NULO	Negative Unliquidated Obligation
NWC	Naval War College
NWCF	Navy Working Capital Fund
O&M	Operations and Maintenance
O&M, A	Operations and Maintenance, Army
O&M, AF	Operations and Maintenance, Air Force
O&M,MC	Operations and Maintenance, Marine Corps

O&M,N	Operations and Maintenance, Navy
O&M,NR	Operations and Maintenance, Navy Reserve
OAP	Obligation Availability Period
OB	Operating Budget
OGE	Office of Government Ethics
OICC	Officer in Charge of Construction
OMB	Office of Management and Budget
OPFORCES	Operating Forces
OPLOC	Operating Location
OPM	Office of Personnel Management
OPN	Other Procurement, Navy
OPNAV	Office of the Chief of Naval Operations
OPNAVINST	Instructions from the Office of the Chief of Naval Operations
OPTAR	Operating Target
ORF	Official Representation Funds
OSD	Office of Secretary of Defense
OT&E	Organize, Train, & Equip
P&R	Programs & Resources
PA&E	Program Analysis & Evaluation
PAA	Property Accounting Activity
PAO	Principal Administering Office
PACFLT	U.S. Pacific Fleet
PAN&MC	Procurement of Ammunition, Navy and Marine Corps
PART	Program Rating Assessment Tool
PB	President's Budget
PBAS	Program Budget Accounting System
PBD	Program Budget Decision
PBIS	Program & Budget Information System
PBWG	Program Budget Coordination Group
PC	Price Change
PCO	Procurement Contracting Officer
PCP	Program Change Proposal
PCS	Permanent Change of Station
PD	Problem Disbursement
PDM	Program Decision Memorandum
PE	Program Element
PL	Public Law
PM	Program Manager
PMA	President's Management Agenda
PMB	Performance Measurement Baseline
PMC	Procurement, Marine Corps
PMRS	Performance Management and Recognition System (old)
PO	Project Order
POM	Program Objectives Memorandum
PP&E	Plant, Property & Equipment
PPA	Prompt Payment Act

PPB	Program Policy Board
PPBE	Planning, Programming, Budgeting and Execution System
PPC	Proposed Program Change
PPM	Personal Property Manager
PR	Purchase Request; Program Review
PTA	Purpose, Time, Amount
PWLA	Public Works Lead Activity
PWO	Public Works Officer
PY	Prior Year
QA	Quality Assurance
QDR	Quadrennial Defense Review
QSI	Quality Step Increase
R3B	Resource & Requirements Review Board
RCP	Request for Contractual Procurement
RDD	Resource Decision Document
RDT&E,N	Research, Development, Test & Evaluation, Navy
RFP	Request for Proposal
RIC	Resource Identification Code
RIF	Reduction in Force
RMD	Resource Management Decision
RMS	Resource Management System
RO	Responsible Office
ROICC	Resident Officer in Charge of Construction
RPM	Real Property Maintenance (replaced by SRM)
RPN	Reserve Personnel, Navy
RS	Resource Sponsor
RV	Recreational Vehicle
RWO	Reimbursable Work Order
SA	Suballocation Holder
SABRS	Standard Accounting, Budgeting and Reporting System
SAC	Senate Appropriations Committee/Special Accounting Class
SAG	Subactivity Group
SASC	Senate Armed Services Committee
SCN	Shipbuilding & Conversion, Navy
SDN	Standard Document Number
SECDEF	Secretary of Defense
SECNAV	Secretary of the Navy
SES	Senior Executive Service
SGL	Standard General Ledger
SLRG	Senior Leadership Review Group
SOCOM	U.S. Special Operations Command
SOP	Standard Operating Procedures
SOW	Statement of Work
SPAWAR	Space & Naval Warfare Systems Command
SPD	Strategic Planning Document
SPG	Strategic Planning Guidance

SPP	Sponsor Program Proposal
SPS	Standard Procurement System
SRM	Sustainment, Restoration and Modernization (formerly, RPM)
STARS	Standard Accounting & Reporting System
STARS-FL	Standard Accounting & Reporting System – Field Level
SV	Schedule Variance
SWE	Surface Warfare Enterprise
SYSCOM	Systems Command
TAC	Type of Address Code/Transportation Account Code
TCO	Termination Contracting Officer
TIR	Transaction Item Report
TOA	Total Obligation Authority
TSP	Thrift Savings Plan
UCG	Unit Cost Goal
UCP	Unified Command Plan
UFR	Unfunded Requirement
UIC	Unit Identification Code
UMD	Unmatched Disbursement
UNICOR	Federal Prison Industries, Inc.
USC	United States Code
USD	Under Secretary of Defense
USD (C)	Under Secretary of Defense for Comptroller
USGSGL	United States Government Standard General Ledger
USJFCOM	US Joint Forces Command
USNORTHCOM	US Northern Command
USPACOM	US Pacific Command
USSOCOM	US Special Operations Command
USSOUTHCOM	US Southern Command
USSTRATCOM	US Strategic Command
USTRANSCOM	US Transportation Command
VERA	Voluntary Early Retirement Authority
VPN	Virtual Private Network
VSIP	Voluntary Separation Incentive Pay
WACC	Weighted Average Cost of Capital
WARNORD	Warning Order
WBS	Work Breakdown Structure
WCF	Working Capital Fund
WG	Wage Grade
WGI	Within Grade Increase
WL	Wage Leader
WPN	Weapons Procurement, Navy
WS	Wage Supervisor
YTD	Year to Date

Appendix C: Websites of Interest to Financial Managers

Acronym Finder (http://www.acronymfinder.com/)

American Society of Military Comptrollers (http://asmconline.org)

ASN(FM&C) (http://www.finance.hq.navy.mil/fmc/default.asp)

Association of Government Accountants (http://www.agacgfm.org/)

Center for Strategic and Budgetary Assessment (http://www.csbaonline.org/)

Congressional Budget Office (http://www.cbo.gov)

Constitution of the United States (http://www.archives.gov/exhibit_hall/charters_of_freedom/constitution/constitution_transcription.html)

CQ Weekly (http://library2.cqpress.com/cqweekly/)

C-SPAN Online (http://www.c-span.org)

Defense Acquisition Knowledge Sharing (http://akss.dau.mil/jsp/default.jsp)

Defense Acquisition University (http://www.dau.mil)

Defense Finance and Accounting Service (http://www.dfas.mil)

Defense Information Systems Activity (http://www.disa.mil)

Defense Technical Information Center (http://www.dtic.mil)

U.S. Department of Defense (http://www.defense.gov)

DFAS Reference Library (http://www.dfas.mil/more/referencelibrary.html)

Director, Cost Assessment and Program Evaluation (http://www.pae.osd.mil/)

DoD Directives/Instructions/Pubs/Memoranda (http://www.dtic.mil/whs/directives/)

DoD Forms (http://www.dtic.mil/whs/directives/infomgt/forms/formsprogram.htm)

DoD & Military e-Journals (http://www.au.af.mil/au/aul/periodicals/dodelecj.htm)

DoD Office of Legislative Counsel (http://www.dod.mil/dodgc/olc/)

Early Bird (http://ebird.osd.mil/)

Earned Value Management (http://www.acq.osd.mil/pm/)

FedLaw (http://www.thecre.com/fedlaw/default.htm)

FedNet Coverage of Congress (http://www.fednet.net/)

Financial Management Regulations (http://comptroller.defense.gov/fmr/)

GAO and Comptroller General Reports (http://www.gao.gov/docsearch/repandtest.html)

GAO Red Book (http://www.gao.gov/legal/index.html)

Glossary of Terms (https://acc.dau.mil/CommunityBrowser.aspx?id=21924)

Government Executive (http://www.govexec.com/)

Heritage Foundation (http://www.heritage.org/)

Historical Tables (http://www.whitehouse.gov/omb/budget/Historicals)

IT Financial Management Association (http://www.isfma.com/index.html)

Library of Congress (http://www.loc.gov/index.html)

Marine Orders and Directives (http://www.marines.mil/news/publications/Pages/Orders.aspx)

National Archives Research Room (http://www.archives.gov/research_room/index.html)

Naval Audit Service (http://secnavportal.donhq.navy.mil/portal/server.pt?space=CommunityPage&control=SetCommunity&CommunityID=303)

Navy Budget Guidance Manual (http://www.finance.hq.navy.mil/fmc/Prod_BudgetManual.asp)

Navy Ethics Office (http://www.ethics.navy.mil)

Navy FM Policy Manual (http://www.finance.hq.navy.mil/fmc/PDF/P_1000_chg_67.pdf)

Naval War College (http://www.nwc.navy.mil/studentinfo/)

Office of the Assistant Secretary of Defense (NII) / CIO (http://www.dod.mil/nii/)

Office of the Secretary of Defense (http://www.defense.gov/osd/)

Office of the Undersecretary of Defense (Comptroller) (http://comptroller.defense.gov/)

OMB (http://www.whitehouse.gov/omb/)

OMB Circulars (http://www.whitehouse.gov/omb/circulars/index.html)

PBISweb (https://pbis.nmci.navy.mil/)

Peter G. Peterson Foundation (http://www.pgpf.org/)

PPBE Course (See PBISweb drop down menu on lower left corner of PBISweb)

Research Resources for GSBPP at Knox Library (http://www.nps.edu/Library/)

Roll Call – the Newspaper of Capital Hill (http://www.rollcall.com)

Treasury's Don't Buy List (http://arc.publicdebt.treas.gov/fs/fsdontbuy.htm)

USA.gov (http://www.usa.gov/)

U.S. Code (http://www4.law.cornell.edu/uscode/index.html)

U.S. Government Manual: 2009-2010 Edition (http://www.gpoaccess.gov/gmanual/browse-gm-09.html)

U.S. House of Representatives (http://www.house.gov)

U.S. Senate (http://www.senate.gov)

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Changes - Record of changes to this handbook

1st to 2nd edition: OPNAV reorganization added
2nd to 3rd edition: Personal Property changes; updated appropriations and working capital fund areas; minor corrections
3rd edition revision 1: Personal Property changes: minor property threshold changed from $2,500 to $5,000.
3rd edition revision 2: Typographical errors corrected
3rd edition revision 3: Updated appropriations, added forms for reimbursables
3rd edition revision 4: Changed the minor construction threshold for the use of O&M dollars from $500K to $750K per the 2002 Authorization Act
3rd edition revision 5: Changed the minor construction threshold from $100K-$500K to $100K-$750K for the definition of minor construction in the working capital fund.
4th edition: Restructured the presentation of the material to its current format. Changed PPBS to reflect concurrent program and budget reviews at OSD level. Incorporated minor corrections.
5th edition: Further restructured the presentation of the material. Included a financial management history of the United States to put the legislative portion in historical context. Updated the PPBS process to reflect Capability Plans, concurrent review, and revised calendars. Incorporated DoD organizational changes. Included the provisions of SECNAVINST 7000.27 (Comptroller Organizations). Included additional information on fiscal (appropriation) law. Corrected errors related to project orders, property accounting, and OMB guidance on apportionment. Expanded the overview of the ethics chapter to place OGE guidance in the framework of philosophical ethical thought. Updated references to funding levels to reflect the FY04 President's Budget. Included a list of useful websites. Eliminated copies of forms.
5th edition, revision 1: Typographical errors corrected.
5th edition, revision 2: Inserted a Table of Figures. Made minor changes to the history in Chapter 1. Included updates to Chapter 4 on the PPBE process, including information on MID-913, and the PR-05 and POM-06 processes. Updated organization charts in Chapter 5. Added information on the National Security Personnel System to Chapter 12.
6th edition: Editorial changes were made throughout the book. Eliminated the appendices with specific appropriation examples and the activity checklist due to obsolescence. Added appendices on military construction and the defense health program and medical financial management issues to reflect the growing number of students from these disciplines. Updated the PPBE section to include POM-06 changes. Added a chapter on performance measurement.
6th edition, revision 1: Corrected problem with captions and missing figure.
7th edition: Updated every chapter, figure, reference, and link. New information added in the following chapters: PPBE, Civilian Personnel, Department of Defense Accounting, and Contracting Overview. New topics include PPBE since MID-913, Combatant Commanders and their role in DoD, NSPS basic information (such as classification structure, career groups, performance rating,

payout eligibility, performance rating, payout shares, and pay increases). Other new topics include Enterprise Resource Planning (ERP) and Earned Value Management (EVM). Added 151 acronyms that were in the text but not reflected in Appendix B. Updated the existing links and added new FM links in Appendix C. Removed Appendix D and E from printed text and added it to the CD provided to all PCC students. Material is not discussed in the PCC course.

8th edition: Clarified language in the Appropriated Funds chapter. Expanded the Performance Measurement chapter to include some of the federal agency metrics as well as the financial management measures specific to the Department of Navy. Updated the acronym list in Appendix B. Made minor typographical corrections. Updated the capital investment threshold in chapter 9 for Working Capital Funds. Updated figures 5, 23, 32, and 36. Updated the accounting cycle table in Chapter 10.

8th edition, revision 1: Clarified the definition of FTE in chapter 12. Revised the PPBE chapter to reflect the change in planning documents. Removed reference to SPG and added the GDF and GEF as replacing the SPG. Updated all the charts, particularly chapters 1-6 that are date/time sensitive. Clarified language in chapter 5 concerning the navy vision, Naval Power 21. Updated the capitalization threshold in chapters 9 and 14. Updated the list of acronyms and web sites.

8th edition, revision 2: Replaced all reference to PWCs with Facility Engineering Command.

9th edition:

Chapter 2 – added guidance and reference on reserve funds. Added language on funds limitations.

Chapter 3 – updated all charts. Added language to the federal spending discussion.

Chapter 4 – expanded the FMB/FMO responsibilities text. Updated CNO OPNAV organization changes (combining N2/N6). Added language referring to JFCOM closure. Removed reference to N6/N6. Added language on N8F re-organization. Updated N8 organization charts and responsibilities. Updated all references.

Chapter 5 – removed all reference to MID-913. Added discussion on SECDEF guidance memo of April 2010 on tail-to-tooth reinvestment. Revised language to delete Capability Sponsor and added language on Capability Portfolio Managers. Deleted discussion on allocation decision segments and 1st year of transition (related to MID-913). Expanded discussion on FYDP. Revised PPBE schedule discussion IAW new guidance. Added a chapter summary to connect main topics and sub-topics together.

Chapter 6 – Expanded discussion on organization responsibilities. Added language on PAO. Added example tracing RO, Resource Sponsor, Appropriation Sponsor, BSO, PAO, and SYSCOM. Included updates and discussion on RMD/RDD/MID. Updated language to reflect changes to PPBE (one vs two budget years, 5 year FYDP, etc). Updated language on contract award fees and incentive fees. Added language to clarify roles and responsibilities, and developed an example to reflect multiple roles served by the

same command and which roles are at the HQ level and which are at lower levels.
Chapter 7 – Expanded language concerning ceiling, floors, fences. Updated funding life cycle chart. Review all language for accuracy.
Chapter 8 – Expanded discussion on interservice/intraservice support. Clarified D&F requirement for Economy Act Orders.
Chapter 11 – Updated obligation and outlay rates chart. Added text to include language on comptroller credibility and techniques for building credibility.
Appendix – Updated all web sites in appendix A and C. Updated acronym list in appendix B to the extent possible.
Chapters 12 and 15-17 were removed. They will be maintained separately since they are no longer required for the new PCC curriculum. They will be available upon request.
All figures, charts, page numbering, figure numbering, references, and web sites were updated.